

CHIMERA INVESTMENT CORP  
Form 10-Q  
November 10, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: SEPTEMBER 30, 2014

OR

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

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

COMMISSION FILE NUMBER: 1-33796

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

MARYLAND

(State or other jurisdiction of incorporation or  
organization)

26-0630461

(IRS Employer Identification No.)

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

(Address of principal executive offices)

10036  
(Zip Code)

(646) 454-3759

(Registrant's telephone number, including area code)

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

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

Yes  No

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

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

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

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

Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Class	Outstanding at November 10, 2014
Common Stock, \$.01 par value	1,027,558,123

CHIMERA INVESTMENT CORPORATION  
FORM 10-Q  
TABLE OF CONTENTS

Part I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements:

Consolidated Statements of Financial Condition as of September 30, 2014 (Unaudited) and December 31, 2013  
(Derived from the audited consolidated financial statements as of December 31, 2013) 1

Consolidated Statements of Operations and Comprehensive Income (Loss) (Unaudited) for the quarters and nine months ended September 30, 2014 and 2013 2

Consolidated Statements of Changes In Stockholders' Equity (Deficit) (Unaudited) for the nine months ended September 30, 2014 and 2013 3

Consolidated Statements of Cash Flows (Unaudited) for the nine months ended September 30, 2014 and 2013 4

Notes to Consolidated Financial Statements (Unaudited) 5

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 43

Item 3. Quantitative and Qualitative Disclosures about Market Risk 69

Item 4. Controls and Procedures 73

Part II. OTHER INFORMATION 74

Item 1. Legal Proceedings 74

Item 1A. Risk Factors 74

Item 6. Exhibits 75

SIGNATURES S-1

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

	September 30, 2014 (Unaudited)	December 31, 2013 (1)
Assets:		
Cash and cash equivalents	\$241,643	\$77,629
Non-Agency RMBS, at fair value		
Senior	239,934	89,687
Senior interest-only	207,840	229,065
Subordinated	439,967	457,569
Subordinated interest-only	7,340	16,571
Agency RMBS, at fair value		
Pass-through	7,955,805	1,954,796
Interest-only	114,169	42,782
Receivable for investments sold	-	253,541
Accrued interest receivable	32,640	15,821
Other assets	99,038	1,763
Derivatives, at fair value, net	7,800	8,095
Subtotal	9,346,176	3,147,319
Assets of Consolidated VIEs:		
Non-Agency RMBS transferred to consolidated variable interest entities ("VIEs"), at fair value	2,528,335	2,981,571
Securitized loans held for investment, net of allowance for loan losses of \$7 million and \$9 million, respectively	678,866	783,484
Securitized loans held for investment, at fair value	4,816,551	-
Accrued interest receivable	40,587	17,173
Other Assets	80,454	6,534
Subtotal	8,144,793	3,788,762
Total assets	\$17,490,969	\$6,936,081
Liabilities:		
Repurchase agreements, RMBS (\$8.5 billion and \$1.7 billion pledged as collateral, respectively)	\$7,838,163	\$1,658,561
Accrued interest payable	25,941	1,397
Dividends payable	92,461	297,904
Payable for investments purchased	848,131	-
Accounts payable and other liabilities	664	1,861
Investment management fees and expenses payable to affiliate	8,540	5,658
Derivatives, at fair value, net	16,222	30,199
Subtotal	8,830,122	1,995,580
Non-Recourse Liabilities of Consolidated VIEs		
Securitized debt, collateralized by Non-Agency RMBS (\$2.5 billion and \$3.0 billion pledged as collateral, respectively)	742,894	933,732
Securitized debt, collateralized by loans held for investment (\$673 million and \$763 million pledged as collateral, respectively)	572,742	669,981

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Securitized debt at fair value, collateralized by loans held for investment (\$4.8 billion pledged as collateral)	3,737,602	-
Accrued interest payable	16,383	5,278
Subtotal	5,069,621	1,608,991
Total liabilities	\$ 13,899,743	\$ 3,604,571

Commitments and Contingencies (See Note 16)

Stockholders' Equity:

Preferred Stock: par value \$0.01 per share; 100,000,000 shares authorized, 0 shares issued and outstanding, respectively	\$-	\$-
Common stock: par value \$0.01 per share; 1,500,000,000 shares authorized, 1,027,508,880 and 1,027,626,237 shares issued and outstanding, respectively	10,273	10,272
Additional paid-in-capital	3,605,406	3,605,241
Accumulated other comprehensive income (loss)	945,006	990,803
Retained earnings (accumulated deficit)	(969,459 )	(1,274,806)
Total stockholders' equity	\$3,591,226	\$3,331,510
Total liabilities and stockholders' equity	\$17,490,969	\$6,936,081

(1) Derived from the audited consolidated financial statements.

See accompanying notes to consolidated financial statements.

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

	For the Quarter Ended		For the Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Net interest income:				
Interest income	\$86,613	\$38,818	\$171,125	\$101,514
Interest expense	(9,902 )	(1,580 )	(15,132 )	(5,042 )
Interest income, Assets of consolidated VIEs	103,742	91,543	274,215	282,207
Interest expense, Non-recourse liabilities of consolidated VIEs	(28,984 )	(23,494 )	(66,859 )	(75,472 )
Net interest income (expense)	151,469	105,287	363,349	303,207
Other-than-temporary impairments:				
Total other-than-temporary impairment losses	(726 )	(2,209 )	(4,939 )	(2,209 )
Portion of loss recognized in other comprehensive income (loss)	(1,264 )	(14,246 )	(3,932 )	(20,409 )
Net other-than-temporary credit impairment losses	(1,990 )	(16,455 )	(8,871 )	(22,618 )
			-	
Other gains (losses):				
Net unrealized gains (losses) on derivatives	12,975	27	(11,720 )	18,607
Net realized gains (losses) on derivatives	(23,152 )	(3,391 )	(48,692 )	(14,312 )
Net gains (losses) on derivatives	(10,177 )	(3,364 )	(60,412 )	4,295
Net unrealized gains (losses) on financial instruments at fair value	162,921	(27,874 )	183,722	(41,861 )
Net realized gains (losses) on sales of investments	64,107	18,816	68,145	72,939
Gain on deconsolidation	-	-	47,846	-
Loss on Extinguishment of Debt	-	-	(2,184 )	-
Total other gains (losses)	216,851	(12,422 )	237,117	35,373
Net investment income (loss)	366,330	76,410	591,595	315,962
			-	
Other (income) and expenses:				
Management fees	9,381	6,570	21,873	19,517
Expense recoveries from Manager	(1,975 )	(1,082 )	(4,820 )	(6,252 )
Net management fees	7,406	5,488	17,053	13,265
(Income)/expense for change in loan loss provision	(645 )	(69 )	(112 )	(1,348 )
General and administrative expenses	5,772	3,624	15,718	13,668
Other (income) expense	(23,783 )	-	(23,783 )	-
Total other income and expenses	(11,250 )	9,043	8,876	25,585
Income (loss) before income taxes	377,580	67,367	582,719	290,377
Income taxes	-	-	2	2

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Net income (loss)	\$377,580	\$67,367	\$582,717	\$290,375
Net income (loss) per share available to common shareholders:				
Basic	\$0.37	\$0.07	\$0.57	\$0.28
Diluted	\$0.37	\$0.07	\$0.57	\$0.28
Weighted average number of common shares outstanding:				
Basic	1,027,183,380	1,027,121,439	1,027,218,024	1,027,075,627
Diluted	1,027,508,880	1,027,559,189	1,027,543,738	1,027,582,582
Dividends declared per share of common stock				
	\$0.09	\$0.09	\$0.27	\$0.27
Comprehensive income (loss):				
Net income (loss)	\$377,580	\$67,367	582,717	290,375
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities, net	(74,155 )	(33,176 )	63,995	61,836
Reclassification adjustment for net losses included in net income (loss) for other-than-temporary credit impairment losses	1,990	16,455	8,871	22,618
Reclassification adjustment for net realized losses (gains) included in net income (loss)	(62,477 )	(18,816 )	(70,817 )	(72,939 )
Reclassification adjustment for gain on deconsolidation included in net income	-	-	(47,846 )	-
Other comprehensive income (loss)	(134,642 )	(35,537 )	(45,797 )	11,515
Comprehensive income (loss)	\$242,938	\$31,830	\$536,920	\$301,890

See accompanying notes to consolidated financial statements.

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

	Common Stock Par Value	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total
Balance, December 31, 2012	\$10,268	\$3,604,554	\$ 989,936	\$ (1,062,279 )	\$3,542,479
Net income	-	-	-	290,375	290,375
Unrealized gains (losses) on available-for-sale securities, net	-	-	61,836	-	61,836
Reclassification adjustment for net losses included in net income (loss) for other-than- temporary credit impairment losses	-	-	22,618	-	22,618
Reclassification adjustment for net realized losses (gains) included in net income (loss)	-	-	(72,939 )	-	(72,939 )
Proceeds from restricted stock grants	3	236	-	-	239
Common dividends declared, \$0.27 per share	-	-	-	(277,309 )	(277,309 )
Balance, September 30, 2013	\$10,271	\$3,604,790	\$ 1,001,451	\$ (1,049,213 )	\$3,567,299
Balance, December 31, 2013	\$10,272	\$3,605,241	\$ 990,803	\$ (1,274,806 )	\$3,331,510
Net income	-	-	-	582,717	582,717
Unrealized gains (losses) on available-for-sale securities, net	-	-	63,995	-	63,995
Reclassification adjustment for net losses included in net income (loss) for other-than- temporary credit impairment losses	-	-	8,871	-	8,871
Reclassification adjustment for net realized losses (gains) included in net income (loss)	-	-	(70,817 )	-	(70,817 )
Reclassification adjustment for gain on deconsolidation included in net income	-	-	(47,846 )	-	(47,846 )
Proceeds from restricted stock grants	1	165	-	-	166
Common dividends declared, \$0.27 per share	-	-	-	(277,370 )	(277,370 )
Balance, September 30, 2014	\$10,273	\$3,605,406	\$ 945,006	\$ (969,459 )	\$3,591,226

See accompanying notes to consolidated financial statements.



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

	For the Nine Months Ended	
	September 30, 2014	September 30, 2013
Cash Flows From Operating Activities:		
Net income (loss)	\$ 582,717	\$ 290,375
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
(Accretion) amortization of investment discounts/premiums, net	(51,284 )	(56,211 )
Amortization of deferred financing costs	1,673	5,215
Accretion (amortization) of securitized debt discounts/premiums, net	7,782	8,964
Net unrealized losses (gains) on derivatives	11,720	(18,607 )
Net realized losses (gains) on option contracts settled	1,246	-
Proceeds (payments) for derivative sales and settlements	(1,076 )	-
Margin (paid) received on derivatives	(111,904 )	-
Net unrealized losses (gains) on financial instruments at fair value	(183,722 )	41,861
Net realized losses (gains) on sales of investments	(68,145 )	(72,939 )
Gain on deconsolidation	(47,846 )	-
Net other-than-temporary credit impairment losses	8,871	22,618
Loss on extinguishment of securitized debt	2,184	-
Provision for loan losses, net	(112 )	(1,348 )
Equity-based compensation expense	169	239
Changes in operating assets:		
Decrease (increase) in accrued interest receivable, net	(39,698 )	2,144
Decrease (increase) in other assets	(9,921 )	(617 )
Decrease (increase) in other assets of consolidated VIEs	15,393	-
Changes in operating liabilities:		
Increase (decrease) in accounts payable and other liabilities	(1,197 )	2,079
Increase (decrease) in investment management fees and expenses payable to affiliate	2,882	(818 )
Increase (decrease) in accrued interest payable, net	35,649	(3,699 )
Net cash provided by (used in) operating activities	\$ 155,381	219,256
Cash Flows From Investing Activities:		
Agency RMBS portfolio:		
Purchases	(7,456,073 )	(1,377,380)
Sales	1,910,389	437,440
Principal payments	267,809	424,420
Non-Agency RMBS portfolio:		
Purchases	(316,728 )	(219,798 )
Sales	299,804	189,925
Principal payments	31,605	6,418
Non-Agency RMBS transferred to consolidated VIEs:		
Sales	211,164	-
Principal payments	214,634	372,504
Securitized loans held for investment:		
Principal payments	139,809	462,920

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Acquisition of securities in consolidated VIEs	(774,350 )	-
Net cash provided by (used in) investing activities	\$ (5,471,937 )	296,449
Cash Flows From Financing Activities:		
Proceeds from repurchase agreements	\$ 17,795,611	5,589,715
Payments on repurchase agreements	(11,616,008)	(5,528,415)
Proceeds from securitized debt borrowings, collateralized by loans held for investment	128,173	-
Payments on securitized debt borrowings, collateralized by loans held for investment	(144,183 )	(456,233 )
Payments on securitized debt borrowings, collateralized by Non-Agency RMBS	(144,138 )	(339,134 )
Repurchase of securitized debt borrowings, collateralized by Non-Agency RMBS	(56,072 )	-
Common dividends paid	(482,813 )	(277,300 )
Net cash provided by (used in) financing activities	\$ 5,480,570	(1,011,367)
Net increase (decrease) in cash and cash equivalents	164,014	(495,662 )
Cash and cash equivalents at beginning of period	77,629	621,153
Cash and cash equivalents at end of period	\$ 241,643	\$ 125,491
Supplemental disclosure of cash flow information:		
Interest received	\$ 353,825	\$ 329,654
Interest paid	\$ 36,887	\$ 70,035
Management fees and expenses paid to affiliate	\$ 18,991	\$ 20,335
Non-cash investing activities:		
Receivable for investments sold	\$ -	\$ 197,554
Payable for investments purchased	\$ 848,131	\$ 4,810
Net change in unrealized gain (loss) on available-for sale securities	\$ (45,797 )	\$ 11,515
Transfer out of Non-Agency RMBS Transferred to consolidated VIEs	\$ (54,916 )	\$ -
Transfer into Non-Agency RMBS	\$ 54,916	\$ -
Acquisition of securities in consolidated VIEs		
Securitized loans held for investment, at fair value	\$ 4,722,825	\$ -
Other assets of consolidated VIEs	\$ 84,830	\$ -
Securitized debt at fair value	\$ 4,033,304	\$ -
Non-cash financing activities:		
Common dividends declared, not yet paid	\$ 92,461	\$ 92,440

See accompanying notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

---

1. Organization

Chimera Investment Corporation (the “Company”) was organized in Maryland on June 1, 2007. The Company commenced operations on November 21, 2007 when it completed its initial public offering. The Company elected to be taxed as a real estate investment trust (“REIT”) under the Internal Revenue Code of 1986, as amended, and regulations promulgated thereunder (the “Code”). The Company formed the following wholly-owned qualified REIT subsidiaries: Chimera Securities Holdings, LLC in July 2008; Chimera Asset Holding LLC and Chimera Holding LLC in June 2009; and Chimera Special Holding LLC in January 2010 which is a wholly-owned subsidiary of Chimera Asset Holding LLC. In July 2010, the Company formed CIM Trading Company LLC, a wholly-owned taxable REIT subsidiary (“TRS”). In October 2013, the Company formed Chimera Funding TRS LLC, which is a wholly-owned TRS.

Annaly Capital Management, Inc. (“Annaly”) owns approximately 4.4% of the Company’s common shares as of September 30, 2014. The Company is managed by Fixed Income Discount Advisory Company (“FIDAC”), an investment advisor registered with the Securities and Exchange Commission (“SEC”). FIDAC is a wholly-owned subsidiary of Annaly.

2. Summary of the Significant Accounting Policies

(a) Basis of Presentation and Consolidation

The accompanying consolidated financial statements and related notes of the Company have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). In the opinion of management, all adjustments considered necessary for a fair presentation of the Company's financial position, results of operations and cash flows have been included. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2013. Certain prior year amounts have been reclassified to conform to the current year’s presentation.

The consolidated financial statements include, on a consolidated basis, the Company’s accounts, the accounts of its wholly-owned subsidiaries, and variable interest entities (“VIEs”) in which the Company is the primary beneficiary. All intercompany balances and transactions have been eliminated in consolidation.

The Company uses securitization trusts considered to be VIEs in its securitization and re-securitization transactions. VIEs are defined as entities in which equity investors (i) do not have the characteristics of a controlling financial interest, and/or (ii) do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The entity that consolidates a VIE is known as its primary beneficiary, and is generally the entity with (i) the power to direct the activities that most significantly impact the VIEs’ economic performance, and (ii) the right to receive benefits from the VIE or the obligation to absorb losses of the VIE that could be significant to the VIE. For VIEs that do not have substantial on-going activities, the power to direct the activities that most significantly impact the VIEs’ economic performance may be determined by an entity’s involvement with the design and structure of the VIE.

The trusts are structured as pass through entities that receive principal and interest on the underlying collateral and distribute those payments to the certificate holders. The assets held by the securitization entities are restricted in that

they can only be used to fulfill the obligations of the securitization entity. The Company's risks associated with its involvement with these VIEs are limited to its risks and rights as a certificate holder of the bonds it has retained. There have been no recent changes to the nature of risks associated with the Company's involvement with VIEs.

Determining the primary beneficiary of a VIE requires significant judgment. The Company determined that for the securitizations it consolidates, its ownership of substantially all subordinate interests provided the Company with the obligation to absorb losses and/or the right to receive benefits from the VIE that could be significant to the VIE. In addition, the Company is considered to have the power to direct the activities of the VIEs that most significantly impact the VIEs' economic performance ("power") or the Company was determined to have power in connection with its involvement with the purpose and design of the VIE.

The Company's interest in the assets held by these securitization vehicles, which are consolidated on the Company's Statements of Financial Condition, is restricted by the structural provisions of these entities, and a recovery of the Company's investment in the vehicles will be limited by each entity's distribution provisions. The liabilities of the securitization vehicles, which are also consolidated on the Company's Statements of Financial Condition, are non-recourse to the Company, and can generally only be satisfied from each securitization vehicle's respective asset pool.

The securitization entities are comprised of senior classes of residential mortgage backed securities ("RMBS") and residential mortgage loans. See Notes 3, 4 and 8 for further discussion of the characteristics of the securities and loans in the Company's portfolio.

#### (b) Statements of Financial Condition Presentation

The Company's Consolidated Statements of Financial Condition separately present: (i) the Company's direct assets and liabilities, and (ii) the assets and liabilities of consolidated securitization vehicles. Assets of each consolidated VIE can only be used to satisfy the obligations of that VIE, and the liabilities of consolidated VIEs are non-recourse to the Company. The Company is not obligated to provide, nor does it intend to provide, any financial support to these consolidated securitization vehicles.

The Company has aggregated all the assets and liabilities of the consolidated securitization vehicles due to the determination that these entities are substantively similar and therefore a further disaggregated presentation would not be more meaningful. The notes to the consolidated financial statements describe the Company's direct assets and liabilities and the assets and liabilities of consolidated securitization vehicles. See Note 8 for additional information related to the Company's investments in consolidated securitization vehicles.

#### (c) Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and cash deposited overnight in money market funds, which are not bank deposits and are not insured or guaranteed by the Federal Deposit Insurance Corporation. There were no restrictions on cash and cash equivalents at September 30, 2014 and December 31, 2013.

#### (d) Agency and Non-Agency Residential Mortgage-Backed Securities

The Company invests in RMBS representing interests in obligations backed by pools of mortgage loans. The Company delineates between Agency RMBS and Non-Agency RMBS as follows: Agency RMBS are mortgage pass-through certificates, collateralized mortgage obligations ("CMOs"), and other RMBS representing interests in or obligations backed by pools of mortgage loans issued or guaranteed by agencies of the U.S. Government, such as Ginnie Mae, or federally chartered corporations such as Freddie Mac or Fannie Mae where principal and interest repayments are guaranteed by the respective agency of the U.S. Government or federally chartered corporation. Non-Agency RMBS are not issued or guaranteed by a U.S. Government Agency or other institution and are subject to credit risk. Repayment of principal and interest on Non-Agency RMBS is subject to the performance of the mortgage loans or RMBS collateralizing the obligation.

The Company classifies its RMBS as available-for-sale, records investments at estimated fair value as described in Note 5 of these consolidated financial statements, and includes unrealized gains and losses considered to be temporary on all RMBS, excluding interest-only (“IO”) strips, in Other comprehensive income (loss) in the Consolidated Statements of Operations and Comprehensive Income (Loss). IO strips are recorded at estimated fair value and all unrealized gains and losses are included in earnings in the Consolidated Statements of Operations and Comprehensive Income (Loss). From time to time, as part of the overall management of its portfolio, the Company may sell any of its RMBS investments and recognize a realized gain or loss as a component of earnings in the Consolidated Statements of Operations and Comprehensive Income (Loss) utilizing the average cost method.

The Company's accounting policy for interest income and impairment related to its RMBS is as follows:

#### Interest Income Recognition

The recognition of interest income on RMBS securities varies depending on the characteristics of the security as follows:

#### Agency RMBS and Non-Agency RMBS of High Credit Quality

The Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 310-20, Nonrefundable Fees and Other Costs ("ASC 310-20") is applied to the recognition of interest income for the following securities:

##### Agency RMBS

Non-Agency RMBS that meet all of the following conditions at the acquisition date (referred to hereafter as "Non-Agency RMBS of High Credit Quality"):

1. Rated AA or higher by a nationally recognized credit rating agency. The Company uses the lowest rating available.
2. The Company expects to collect all of the security's contractual cash flows.
3. The security cannot be contractually prepaid such that the Company would not recover substantially all of its recorded investment.

Under ASC 310-20, interest income, including premiums and discounts associated with the acquisition of these securities, is recognized over the life of such securities using the interest method based on the contractual cash flows of the security. In applying the interest method, the Company considers estimates of future principal prepayments in the calculation of the constant effective yield. Differences that arise between previously anticipated prepayments and actual prepayments received, as well as changes in future prepayment assumptions, result in a recalculation of the effective yield on the security on a quarterly basis. This recalculation results in the recognition of an adjustment to the carrying amount of the security based on the revised prepayment assumptions and a corresponding increase or decrease in reported interest income.

#### Non-Agency RMBS Not of High Credit Quality

Non-Agency RMBS that are purchased at a discount and that are not of high credit quality at the time of purchase are accounted for under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality ("ASC 310-30") or ASC 325-40, Beneficial Interests in Securitized Financial Assets ("ASC 325-40") (referred to hereafter as "Non-Agency RMBS Not of High Credit Quality").

Non-Agency RMBS are accounted for under ASC 310-30 if the following conditions are met as of the acquisition date:

1. There is evidence of deterioration in credit quality of the security from its inception.
2. It is probable that the Company will be unable to collect all contractual cash flows of the security.

Non-Agency RMBS that are not within the scope of ASC 310-30 are accounted for under ASC 325-40 if at the acquisition date:

1. The security is not of high credit quality (defined as rated below AA or is unrated), or

2. The security can contractually be prepaid or otherwise settled in such a way that the Company would not recover substantially all of its recorded investment.

7

---



Interest income on Non-Agency RMBS Not of High Credit Quality is recognized using the interest method based on management's estimates of cash flows expected to be collected. The effective interest rate on these securities is based on management's estimate for each security of the projected cash flows, which are estimated based on observation of current market information and include assumptions related to fluctuations in prepayment speeds and the timing and amount of credit losses. Quarterly, the Company reviews and, if appropriate, makes adjustments to its cash flow projections based on inputs and analyses received from external sources, internal models, and the Company's judgments about prepayment rates, the timing and amount of credit losses, and other factors. Changes in the amount and/or timing of cash flows from those originally projected, or from those estimated at the last evaluation date, are considered to be either positive changes or adverse changes. For securities accounted for under ASC 325-40, any positive or adverse change in cash flows that does not result in the recognition of an other-than-temporary impairment ("OTTI") results in a prospective increase or decrease in the effective interest rate used to recognize interest income. For securities accounted for under ASC 310-30, only significant positive changes are reflected prospectively in the effective interest rate used to recognize interest income. Adverse changes in cash flows expected to be collected are generally treated consistently for RMBS accounted for under ASC 325-40 and ASC 310-30, and generally result in recognition of an OTTI with no change in the effective interest rate used to recognize interest income.

## Impairment

### Considerations Applicable to all RMBS

When the fair value of an available-for-sale RMBS is less than its amortized cost the security is considered impaired. On at least a quarterly basis the Company evaluates its securities for OTTI. If the Company intends to sell an impaired security, or it is more-likely-than-not that the Company will be required to sell an impaired security before its anticipated recovery, then the Company must recognize an OTTI through a charge to earnings equal to the entire difference between the investment's amortized cost and its fair value at the measurement date. If the Company does not intend to sell an impaired security and it is not more-likely-than-not that it would be required to sell an impaired security before recovery, the Company must further evaluate the security for impairment due to credit losses. The credit component of OTTI is recognized in earnings and the remaining or non-credit component is recorded as a component of Other comprehensive income (loss) ("OCI"). Following the recognition of an OTTI through earnings, a new amortized cost basis is established for the security and subsequent recoveries in fair value may not be adjusted through earnings.

When evaluating whether the Company intends to sell an impaired security or will more-likely-than-not be required to sell an impaired security before recovery, the Company makes judgments that consider among other things, its liquidity, leverage, contractual obligations, and targeted investment strategy to determine its intent and ability to hold the investments that are deemed impaired. The determination as to whether an OTTI exists is subjective as such determinations are based on factual information available at the time of assessment as well as the Company's estimates of future conditions. As a result, the determination of OTTI and its timing and amount is based on estimates that may change materially over time.

The Company's estimate of the amount and timing of cash flows for its RMBS is based on its review of the underlying securities or mortgage loans securing the RMBS. The Company considers historical information available and expected future performance of the underlying securities or mortgage loans, including timing of expected future cash flows, prepayment rates, default rates, loss severities, delinquency rates, percentage of non-performing loans, extent of credit support available, Fair Isaac Corporation ("FICO") scores at loan origination, year of origination, loan-to-value ratios, geographic concentrations, as well as reports by credit rating agencies, such as Moody's Investors Service, Inc., Standard & Poor's Rating Services or Fitch Ratings, Inc., general market assessments and dialogue with market participants. As a result, substantial judgment is used in the Company's analysis to determine the expected cash flows for its RMBS.

Considerations Applicable to Non-Agency RMBS of High Credit Quality

The impairment assessment for Non-Agency RMBS of High Credit Quality involves comparing the present value of the remaining cash flows expected to be collected to the amortized cost of the security at the assessment date. The discount rate used to calculate the present value of the expected future cash flows is based on the security's effective interest rate as calculated under ASC 310-20 (i.e., the discount rate implicit in the security as of the last measurement date). If the present value of the remaining cash flows expected to be collected is less than the amortized cost basis, an OTTI is recognized in earnings for the difference. This amount is considered to be the credit loss component; the remaining difference between amortized cost and the fair value of the security is considered to be the portion of loss recognized in other comprehensive income (loss).

### Considerations Applicable to Non-Agency RMBS Not of High Credit Quality

Non-Agency RMBS within the scope of ASC 325-40 or ASC 310-30 are considered other-than-temporarily impaired when the following two conditions exist: (1) the fair value is less than the amortized cost basis, and (2) there has been an adverse change in cash flows expected to be collected from the last measurement date (i.e., adverse changes in either the amount or timing of cash flows from those previously expected).

The OTTI is separated into a credit loss component that is recognized in earnings and the portion of loss recognized in other comprehensive income (loss). The credit component is comprised of the impact of the fair value decline due to changes in assumptions related to default (collection) risk and prepayments. The portion of loss recognized in other comprehensive income (loss) comprises the change in fair value of the security due to all other factors, including changes in benchmark interest rates and market liquidity. In determining the OTTI related to credit losses for securities, the Company compares the present value of the remaining cash flows adjusted for prepayments expected to be collected at the current financial reporting date to the present value of the remaining cash flows expected to be collected at the original purchase date (or the last date those estimates were revised for accounting purposes). The discount rate used to calculate the present value of expected future cash flows is the effective interest rate used for income recognition purposes as determined under ASC 325-40 or ASC 310-30.

Following the recognition of an OTTI through earnings for the credit component, a new amortized cost basis is established for the security and subsequent recoveries in fair value may not be adjusted through earnings. However, to the extent that there are subsequent increases in cash flows expected to be collected, the OTTI previously recorded through earnings may be accreted into interest income following the guidance in ASC 325-40 or ASC 310-30.

The determination of whether an OTTI exists and, if so, the extent of the credit component is subject to significant judgment and management's estimates of both historical information available at the time of assessment, the current market environment, as well as the Company's estimates of the future performance and projected amount and timing of cash flows expected to be collected on the security. As a result, the timing and amount of OTTI constitutes an accounting estimate that may change materially over time.

#### (e) Interest-Only RMBS

The Company invests in IO Agency and Non-Agency RMBS strips ("IO RMBS strips"). IO RMBS strips represent the Company's right to receive a specified proportion of the contractual interest flows of the collateral. The Company has accounted for IO RMBS strips at fair value with changes in fair value recognized in the Company's Consolidated Statements of Operations and Comprehensive Income (Loss). The Company has elected the fair value option to account for IO RMBS strips to simplify the reporting of changes in fair value. The IO RMBS strips are included in RMBS, at fair value, on the accompanying Consolidated Statements of Financial Condition. Interest income on IO RMBS strips is accrued based on the outstanding notional balance and the security's contractual terms, and amortization of any premium is calculated in accordance with ASC 325-40. Changes in fair value are presented in Net unrealized gains (losses) on financial instruments at fair value on the Consolidated Statement of Operations and Comprehensive Income (Loss). Included in Non-Agency RMBS transferred to VIEs, at fair value on the Consolidated Statements of Financial Condition are IO RMBS strips carried at fair value with changes in fair value reflected in earnings of \$6 million and \$12 million as of September 30, 2014 and December 31, 2013. Interest income reported on IO securities was \$9 million and \$13 million for the quarters ended September 30, 2014 and 2013, respectively. Interest income reported on IO securities was \$27 million and \$23 million for the nine months ended September 30, 2014 and 2013, respectively.



(f) Securitized Loans Held for Investment, at cost, and Related Allowance for Loan Losses

A portion of the securitized loan portfolio which is carried at amortized cost is comprised primarily of non-conforming, single family, owner occupied, jumbo, prime loans that are not guaranteed as to repayment of principal or interest. These securitized loans are serviced and may be modified, in the event of a default, by a third-party servicer. The Company generally has the ability to approve certain loan modifications and determine the course of action to be taken as it relates to certain loans in default, including whether or not to proceed with foreclosure. These mortgage loans are designated as held for investment, and are carried at their principal balance outstanding, plus any premiums, less discounts and allowances for loan losses. Interest income on loans held for investment is recognized over the expected life of the loans using the interest method. Nonrefundable fees and costs related to acquiring the Company's securitized residential mortgage loans are recognized as expenses over the life of the associated debt using the interest method of amortization. Income recognition is suspended for loans when, based on information from the servicer, a full recovery of interest or principal becomes doubtful.

The Company's general reserve is based on historical loss rates for pools of loans with similar credit characteristics, adjusted for current trends and market conditions, including current trends in delinquencies and severities. The Company has established a specific reserve that reflects consideration of loans more than 60 days delinquent, loans in foreclosure and borrowers that have declared bankruptcy. The loan loss provision related to these loans is measured as the difference between the unpaid principal balance and the estimated fair value of the property securing the mortgage, less estimated costs to sell. The specific reserve also reflects consideration of concessions granted to borrowers by the servicer in the form of modifications (i.e., reductions). Loan loss provisions related to these modifications are based on the contractual principal and interest payments, post-modification, discounted at the loan's original effective interest rate. Loans with specific reserves are individually evaluated for impairment. Loan modifications made by the servicer are evaluated to determine if they constitute troubled debt restructurings ("TDRs"). A restructuring of a loan constitutes a TDR if the servicer, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. Impairment of modified loans considered to be TDRs is measured based on the present value of expected cash flows discounted at the loan's effective interest rate at inception. If the present value of expected cash flows is less than the recorded investment in the loan, an allowance for loan losses is recognized with a corresponding charge to the provision for loan losses. Impairment of all other loans individually evaluated is measured as the difference between the unpaid principal balance and the estimated fair value of the collateral, less estimated costs to sell. The Company charges off the corresponding loan allowance and related principal balance when the servicer reports a realized loss. A complete discussion of securitized loans held for investment is included in Note 4 to these consolidated financial statements.

The Company estimates the fair value of securitized loans as described in Note 5 of these consolidated financial statements.

(g) Securitized Loans Held for Investment, at fair value

A portion of the securitized loan portfolio which is carried at fair value is comprised primarily of seasoned sub-prime residential mortgage loans with a weighted average FICO score of 629 and are not guaranteed as to repayment of principal or interest. These securitized loans are serviced and may be modified, in the event of default, by a third-party servicer. The Company generally has the ability to approve certain loan modifications and determine the course of action to be taken as it relates to certain loans in default, including whether or not to proceed with foreclosure. The Company has elected the fair value option at acquisition for these seasoned sub-prime residential mortgage loans; therefore, they are carried at fair value with changes in fair value recorded as Net unrealized gains (losses) on financial instruments at fair value on the Consolidated Statements of Operations and Comprehensive Income. The Company has also elected fair value option for the related financing for these seasoned sub-prime residential mortgage loans. The Company elected fair value option as it may resecuritize these loans in the

future. Additionally, the fair value option allows both the loans and related financing to be consistently reported and to achieve operational simplifications. The Company recognizes interest income on these loans held for investment over the expected life of the loans using the interest method. Interest is accrued on the securitized loans when due. Interest which is not received at the due date is written off when it becomes delinquent.

The Company estimates the fair value of securitized loans as described in Note 5 of these consolidated financial statements.

Real estate owned ("REO") represents properties which the Company has received the legal title of the property to satisfy the outstanding loan. REO is re-categorized from loan to REO when the Company takes legal title of the property. REO assets are measured and reported at the estimated fair value less the estimated cost to sell at the end of each reporting period. At the time the asset is re-categorized, any difference between the previously recorded loan balance, less any loan loss reserves, and the carrying value of the REO at the time the Company takes legal title of the property, is recognized as a loss. All REO assets of the Company are held-for-sale and it is the Company's intention to sell the property in the shortest time possible to maximize their return and recovery on the previously recorded loan. Total REO assets at September 30, 2014 and December 31, 2013 is \$6 million and \$1 million, respectively and is recorded in other assets of consolidated VIEs on the Company's consolidated statements of financial condition.

(h) Repurchase Agreements

The Company finances the acquisition of a significant portion of its mortgage-backed securities with repurchase agreements. The Company has evaluated each agreement and has determined that each of the repurchase agreements be accounted for as secured borrowings. None of the Company's repurchase agreements are accounted for as components of linked transactions. As a result, the Company separately accounts for the financial assets posted as collateral and related repurchase agreements in the accompanying consolidated financial statements.

(i) Securitized Debt, collateralized by Non-Agency RMBS Transferred to Consolidated VIEs, Securitized Debt, collateralized by loans held for investment, and Securitized debt at fair value, collateralized by loans held at fair value

The Company has issued securitized debt collateralized by "Non-Agency RMBS" and securitized debt collateralized by loans held for investment. The loans held for investment include "jumbo, prime residential mortgage loans" and a "seasoned sub-prime portfolio of residential mortgage loans" acquired during the third quarter of 2014. The jumbo, prime residential mortgage loans and the related securitized debt are carried at amortized cost. The seasoned sub-prime portfolio of residential mortgage loans acquired during the third quarter of 2014 and the related securitized debt are carried at fair value with changes in fair value reflected in earnings. Each of these three groups of securitized debt are discussed in further detail below as well as Note 7 to these consolidated financial statements.

Certain transactions involving residential mortgage loans are accounted for as secured borrowings, and are recorded as Securitized loans held for investment and the corresponding debt as Securitized debt, collateralized by loans held for investment in the Consolidated Statements of Financial Condition. These securitizations are collateralized by residential adjustable or fixed rate mortgage loans that have been placed in a trust and pay interest and principal to the debt holders of that securitization.

Certain re-securitization transactions classified as Securitized debt, collateralized by Non-Agency RMBS reflect the transfer to a trust of fixed or adjustable rate RMBS which are classified as Non-Agency RMBS transferred to consolidated VIEs that pay interest and principal to the debt holders of that re-securitization. Re-securitization transactions completed by the Company that did not qualify as sales are accounted for as secured borrowings. The associated securitized debt is carried at amortized cost.

The Company has elected the fair value option for certain of the Company's securitized debt used to finance the seasoned sub-prime portfolio of residential mortgage loans. The Company has elected fair value option for these financing obligations as it expects to refinance this debt in the future. Additionally, the fair value option allows both the loans and related financing to be consistently reported and to achieve operational simplifications. Debt for which the Company did not elect the fair value option is carried at amortized cost. Changes in fair value for securitized debt carried at fair value is recorded as Net unrealized gains (losses) on financial instruments at fair value on the Consolidated Statements of Operations and Comprehensive Income. Interest expense on all securitized debt is recorded in earnings with premiums and discounts amortized using the interest method. Fees associated with the debt held at amortized cost are also amortized using the interest method.

The Company estimates the fair value of its securitized debt as described in Note 5 to these consolidated financial statements.

(j) Fair Value Disclosure

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





(k) Derivative Financial Instruments

The Company's investment policies permit it to enter into derivative contracts, including interest rate swaps, interest rate caps, options, and futures as a means of managing its interest rate risk as well as to enhance investment returns. The Company's derivatives are recorded as either assets or liabilities in the Consolidated Statements of Financial Condition and measured at fair value. These derivative financial instrument contracts are not designated as hedges for GAAP; therefore, all changes in fair value are recognized in earnings. The Company estimates the fair value of its derivative instruments as described in Note 5 of these consolidated financial statements. Net payments on derivative instruments are included in the Consolidated Statements of Cash Flows as a component of net income (loss). Unrealized gains (losses) on derivatives are removed from net income (loss) to arrive at cash flows from operating activities.

The Company elects to net by counterparty the fair value of its derivative contracts when appropriate. These contracts contain legally enforceable provisions that allow for netting or setting off of all individual swaps receivables and payables with each counterparty and, therefore, the fair value of those swap contracts are reported net by counterparty. The credit support annex provisions of the Company's interest rate swap contracts allow the parties to mitigate their credit risk by requiring the party which is in a net payable position to post collateral. As the Company elects to net by counterparty the fair value of interest rate swap contracts, it also nets by counterparty any cash collateral exchanged as part of the interest rate swap contracts.

(l) Sales, Securitizations, and Re-Securitizations

The Company periodically enters into transactions in which it sells financial assets, such as RMBS, and mortgage loans. Gains and losses on sales of assets are calculated using the average cost method whereby the Company records a gain or loss on the difference between the average amortized cost of the asset and the proceeds from the sale. In addition, the Company from time to time securitizes or re-securitizes assets and sells tranches in the newly securitized assets. These transactions may be recorded as either sales and the assets contributed to the securitization are removed from the Consolidated Statements of Financial Condition and a gain or loss is recognized, or as secured borrowings whereby the assets contributed to the securitization are not derecognized but rather the debt issued by the securitization entity are recorded to reflect the term financing of the assets. In these securitizations and re-securitizations, the Company may retain senior or subordinated interests in the securitized and/or re-securitized assets.

(m) Income Taxes

The Company has elected to be taxed as a REIT and intends to comply with the provision of the Code, with respect thereto. Accordingly, the Company will not be subject to federal, state or local income tax to the extent that qualifying distributions are made to stockholders and as long as certain asset, income, distribution and stock ownership tests are met. If the Company failed to qualify as a REIT and did not qualify for certain statutory relief provisions, the Company would be subject to federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which the REIT qualification was lost. The Company, CIM Trading and CIM Funding TRS made joint elections to treat CIM Trading and CIM Funding TRS as TRS's. As such, CIM Trading and CIM Funding TRS are taxable as domestic C corporations and subject to federal, state, and local income taxes based upon their respective taxable income.

A tax position is recognized only when, based on management's judgment regarding the application of income tax laws, it is more likely than not that the tax position will be sustained upon examination. The Company does not have any unrecognized tax benefits that would affect its financial position or require disclosure. No accruals for penalties and interest were necessary as of September 30, 2014 or December 31, 2013.

(n) Net Income per Share

The Company calculates basic net income per share by dividing net income for the period by the basic weighted-average shares of its common stock outstanding for that period. Diluted net income per share takes into account the effect of dilutive instruments such as unvested restricted stock.

(o) Stock-Based Compensation

The Company accounts for stock-based compensation awards granted to the employees of FIDAC and FIDAC's affiliates at the fair value of the stock-based compensation provided. The Company measures the fair value of the equity instrument using the stock prices and other measurement assumptions as of the earlier of either the date at which a performance commitment by the recipient is reached or the date at which the recipient's performance is complete. Stock compensation expense related to the grants of stock is recognized over the vesting period of such grants based on the fair value of the stock on each quarterly vesting date, at which the recipient's performance is complete.

Compensation expense for equity based awards granted to the Company's independent directors is recognized pro-rata over the vesting period of such awards, based upon the fair value of such awards at the grant date.

(p) 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although the Company's estimates contemplate current conditions and how it expects them to change in the future, it is reasonably possible that actual conditions could be materially different than anticipated in those estimates, which could have a material adverse impact on the Company's results of operations and its financial condition. Management has made significant estimates in accounting for income recognition and OTTI on Agency and Non-Agency RMBS and IO RMBS (Note 3), valuation of Agency and Non-Agency RMBS (Notes 3 and 5), residential mortgage loans (Note 4), securitized debt (Note 7) and derivative instruments (Notes 5 and 9). Actual results could differ materially from those estimates.

(q) Recent Accounting Pronouncements

Broad Transactions

Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40)

In January 2014, the FASB issued ASU No. 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure. This update clarifies when the Company is considered to have obtained physical possession, from an in-substance possession or foreclosure, of a residential real estate property collateralizing a mortgage loan. Current guidance indicates that the Company should reclassify a collateralized mortgage loan such that the loan should be derecognized and the collateral asset recognized when it determines that there has been an in-substance repossession or foreclosure by the Company. This update defines the term in substance repossession or foreclosure to reduce diversity in interpretation of when such an event occurs. The guidance in this update is effective for the Company beginning January 1, 2015. The Company is evaluating the impact of this update.

Transfers and Servicing (Subtopic 860)

In June 2014, the FASB issued ASU No. 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. This update makes limited amendments to the guidance in ASC 860 on accounting for certain repurchase agreements. The ASU requires entities to account for repurchase-to-maturity transactions as secured borrowings, rather than as sales with forward repurchase agreements. The ASU defines a repurchase-to-maturity transaction as a repo that (1) settles at the maturity of the transferred financial asset and (2) does not require the transferor to reacquire the transferred financial asset. In addition, the ASU eliminates accounting guidance on linked repurchase financing

transactions. The ASU also expands disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers accounted for as secured borrowings. The guidance in this update will be effective for the Company beginning January 1, 2015, except for the disclosure requirements for transactions accounted for as secured borrowings, which are required to be presented by the Company in the second quarter of 2015. As of September 30, 2014 and December 31, 2013, the Company does not have any repurchase-to-maturity transactions or any linked repurchase financing transactions, therefore, the Company expects that this standard will impact disclosures only and will not have a significant impact on the consolidated financial statements of the Company.

### Consolidations (Subtopic 810)

In August 2014, the FASB issued ASU No. 2014-13, Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity. This update provides a measurement alternative for consolidated qualifying collateralized financing entities (CFEs). The update defines a CFE as a variable interest entity that holds financial assets, issues beneficial interests in those assets and has no more than nominal equity. The beneficial interests have contractual recourse only to the related assets of the CFE and are classified as financial liabilities. Under the alternative, the Company may elect to measure both the CFE's financial assets and financial liabilities using the fair value of either the CFE's financial assets or financial liabilities, whichever is more observable. The guidance is aimed at eliminating the measurement difference that sometimes arises when a CFE's financial assets and financial liabilities are independently measured at fair value, as required by ASC 820. This update is effective for the Company beginning January 1, 2016. Early adoption is permitted at the beginning of 2015. The guidance provides an exception for reporting entities whose consolidated CFEs don't meet the scope requirements because the entities didn't elect the fair value option when they initially consolidated the CFEs. The guidance allows them to elect, only at the date of adoption, to apply the measurement alternative to the CFEs' financial assets and financial liabilities or continue applying other US GAAP. The Company is evaluating the impact of this update.

### Presentation of Financial Statements—Going Concern (Subtopic 205-40)

In August 2014, the FASB issued ASU No. 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. This update provides guidance on determining when and how to disclose going-concern uncertainties in the financial statements. The new standard requires the Company to perform interim and annual assessments of its ability to continue as a going concern within one year of the date the financial statements are issued. The Company must provide certain disclosures if conditions or events raise substantial doubt about its ability to continue as a going concern. The ASU applies to all entities and is effective for the Company beginning January 1, 2017. Early adoption is permitted. The Company does not expect this update to have any impact as we do not expect to have the conditions or events which would raise substantial doubt about the Company's ability to continue as a going concern.

### 3. Residential Mortgage-Backed Securities

The Company classifies its Non-Agency RMBS as senior, senior IO, subordinated, subordinated IO, and Non-Agency RMBS transferred to consolidated VIEs. The Company also invests in Agency RMBS. Senior interests in Non-Agency RMBS are considered to be entitled to the first principal repayments in their pro-rata ownership interests at the reporting date. The total fair value of the Non-Agency RMBS that are held by consolidated re-securitization trusts was \$2.5 billion and \$3.0 billion at September 30, 2014 and December 31, 2013, respectively. See Note 8 of these consolidated financial statements for further discussion of consolidated VIEs.

The following tables present the principal or notional value, total premium, total discount, amortized cost, fair value, gross unrealized gains, gross unrealized losses, and net unrealized gain (loss) related to the Company's available-for-sale RMBS portfolio as of September 30, 2014 and December 31, 2013, by asset class.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

September 30, 2014  
(dollars in thousands)

	Principal or Notional Value	Total Premium	Total Discount	Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Net Unrealized Gain/(Loss)
<b>Non-Agency RMBS</b>								
Senior	\$312,619	-	(98,669 )	\$213,950	\$239,934	26,534	(550 )	\$25,984
Senior, interest-only	5,383,454	239,047	-	239,047	207,840	13,905	(45,112)	(31,207 )
Subordinated	689,332	-	(352,856 )	336,476	439,967	103,988	(497 )	103,491
Subordinated, interest-only	218,527	9,857	-	9,857	7,340	207	(2,724 )	(2,517 )
<b>RMBS transferred to consolidated VIEs</b>								
	3,226,298	3,676	(1,447,744)	1,737,810	2,528,335	790,525	-	790,525
<b>Agency RMBS</b>								
Pass-through	7,553,614	374,456	(21 )	7,928,049	7,955,805	59,685	(31,929)	27,756
Interest-only	2,016,717	117,111	-	117,111	114,169	639	(3,581 )	(2,942 )
<b>Total</b>	<b>\$19,400,561</b>	<b>\$744,147</b>	<b>\$(1,899,290)</b>	<b>\$10,582,300</b>	<b>\$11,493,390</b>	<b>\$995,483</b>	<b>\$(84,393)</b>	<b>\$911,090</b>

December 31, 2013  
(dollars in thousands)

	Principal or Notional Value	Total Premium	Total Discount	Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Net Unrealized Gain/(Loss)
<b>Non-Agency RMBS</b>								
Senior	\$128,217	\$-	\$(39,395 )	\$88,822	\$89,687	\$974	\$(109 )	\$865
Senior, interest-only	5,742,781	283,271	-	283,271	229,065	11,802	(66,008 )	(54,206 )
Subordinated	830,632	-	(490,400 )	340,232	457,569	119,233	(1,896 )	117,337
Subordinated, interest-only	274,462	14,666	-	14,666	16,571	2,483	(578 )	1,905
<b>RMBS transferred to consolidated VIEs</b>								
	3,912,376	7,490	(1,763,401)	2,075,628	2,981,571	905,943	-	905,943
<b>Agency RMBS</b>								
Pass-through	1,898,131	90,843	(5,004 )	1,983,970	1,954,796	22,320	(51,494 )	(29,174 )
Interest-only	247,344	43,766	-	43,766	42,782	332	(1,316 )	(984 )
<b>Total</b>	<b>\$13,033,943</b>	<b>\$440,036</b>	<b>\$(2,298,200)</b>	<b>\$4,830,355</b>	<b>\$5,772,041</b>	<b>\$1,063,087</b>	<b>\$(121,401)</b>	<b>\$941,686</b>

The table below presents changes in Accretable Yield, or the excess of the security's cash flows expected to be collected over the Company's investment, solely as it pertains to the Company's Non-Agency RMBS portfolio accounted for according to the provisions of ASC 310-30.

For the Quarter Ended

For the Nine Months Ended

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

	September 30, 2014 (dollars in thousands)	September 30, 2013 (dollars in thousands)	September 30, 2014 (dollars in thousands)	September 30, 2013 (dollars in thousands)
Balance at beginning of period	\$ 1,630,153	\$ 1,921,687	\$ 1,794,576	\$ 2,107,387
Purchases	66,249	-	105,814	-
Accretion	(72,665 )	(80,501 )	(223,114 )	(249,431 )
Reclassification (to) from non-accretable difference	4,948	(18,496 )	44,324	(6,831 )
Sales and deconsolidation	(106,801 )	-	(199,716 )	(28,435 )
Balance at end of period	\$ 1,521,884	\$ 1,822,690	\$ 1,521,884	\$ 1,822,690

The table below presents the outstanding principal balance and related amortized cost at September 30, 2014 and December 31, 2013 as it pertains to the Company's Non-Agency RMBS portfolio accounted for according to the provisions of ASC 310-30.

	For the Quarter Ended September 30, 2014 (dollars in thousands)	For the Year Ended December 31, 2013 (dollars in thousands)
Outstanding principal balance:		
Beginning of period	\$ 3,664,543	\$ 4,508,475
End of period	\$ 3,401,226	\$ 3,949,674
Amortized cost:		
Beginning of period	\$ 1,891,872	\$ 2,268,751
End of period	\$ 1,809,403	\$ 2,027,738

The following tables present the gross unrealized losses and estimated fair value of the Company's RMBS by length of time that such securities have been in a continuous unrealized loss position at September 30, 2014 and December 31, 2013. All securities in an unrealized loss position have been evaluated by the Company for OTTI as discussed in Note 2(d).

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

September 30, 2014  
(dollars in thousands)

	Unrealized Loss Position for Less than 12 Months			Unrealized Loss Position for 12 Months or More			Total		
	Estimated Fair Value	Unrealized Losses	Number of Securities	Estimated Fair Value	Unrealized Losses	Number of Securities	Estimated Fair Value	Unrealized Losses	Number of Securities
Non-Agency RMBS									
Senior	\$31,469	\$(550)	4	\$-	\$-	-	\$31,469	\$(550)	4
Senior, interest-only	28,629	(3,735)	27	102,293	(41,377)	56	130,922	(45,112)	83
Subordinated	-	-	-	11,485	(497)	3	11,485	(497)	3
Subordinated, interest-only	4,845	(2,404)	2	1,084	(320)	2	5,929	(2,724)	4
RMBS transferred to consolidated VIEs									
	-	-	-	-	-	-	-	-	-
Agency RMBS									
Pass-through	1,999,279	(5,654)	38	710,935	(26,275)	12	2,710,214	(31,929)	50
Interest-only	80,886	(2,582)	9	11,296	(999)	3	92,182	(3,581)	12
Total	\$2,145,108	\$(14,925)	80	\$837,093	\$(69,468)	76	\$2,982,201	\$(84,393)	156

December 31, 2013  
(dollars in thousands)

	Unrealized Loss Position for Less than 12 Months			Unrealized Loss Position for 12 Months or More			Total		
	Estimated Fair Value	Unrealized Losses	Number of Securities	Estimated Fair Value	Unrealized Losses	Number of Securities	Estimated Fair Value	Unrealized Losses	Number of Securities
Non-Agency RMBS									
Senior	\$28,163	\$(109)	3	\$-	\$-	-	\$28,163	\$(109)	3
Senior interest-only	119,913	(35,252)	54	45,167	(30,756)	28	165,080	(66,008)	82
Subordinated	-	-	-	17,661	(1,896)	2	17,661	(1,896)	2
Subordinated interest-only	1,062	(578)	2	-	-	-	1,062	(578)	2
RMBS transferred to consolidated VIEs									
	-	-	-	-	-	-	-	-	-
Agency RMBS									
Pass-through	1,126,881	(51,494)	30	-	-	-	1,126,881	(51,494)	30



Interest-only	22,246	(1,018 )	4	491	(298 )	3	22,737	(1,316 )	7
Total	\$1,298,265	\$(88,451)	93	\$63,319	\$(32,950)	33	\$1,361,584	\$(121,401)	126

At September 30, 2014, the Company did not intend to sell any of its RMBS that were in an unrealized loss position, and it was not more likely than not that the Company would be required to sell these RMBS before recovery of their amortized cost basis, which may be at their maturity. With respect to RMBS held by consolidated VIEs, the ability of any entity to cause the sale by the VIE prior to the maturity of these RMBS is either expressly prohibited, not probable, or is limited to specified events of default, none of which have occurred as of September 30, 2014.

Gross unrealized losses on the Company's Agency pass-through RMBS were \$32 million and \$51 million at September 30, 2014 and December 31, 2013, respectively. Given the credit quality inherent in Agency RMBS, the Company does not consider any of the current impairments on its Agency pass-through RMBS to be credit related. In evaluating whether it is more likely than not that it will be required to sell any impaired security before its anticipated recovery, which may be at their maturity, the Company considers the significance of each investment, the amount of impairment, the projected future performance of such impaired securities, as well as the Company's current and anticipated leverage capacity and liquidity position. Based on these analyses, the Company determined that at September 30, 2014 and December 31, 2013, unrealized losses on its Agency RMBS were temporary.

Gross unrealized losses on the Company's Non-Agency RMBS (excluding Non-Agency RMBS IO strips which are accounted for under the fair value option with changes in fair value recorded in earnings) were \$1 million and \$2 million at September 30, 2014 and December 31, 2013, respectively. Based upon the most recent evaluation, the Company does not consider these unrealized losses to be indicative of OTTI and does not believe that these unrealized losses are credit related, but rather are due to other factors. The Company has reviewed its Non-Agency RMBS that are in an unrealized loss position to identify those securities with losses that are other-than-temporary based on an assessment of changes in cash flows expected to be collected for such RMBS, which considers recent bond performance and expected future performance of the underlying collateral.

A summary of the OTTI included in earnings for the quarters and nine months ended September 30, 2014 and 2013 is presented below.

	For the Quarter Ended	
	September 30, 2014	September 30, 2013
	(dollars in thousands)	
Total other-than-temporary impairment losses	\$ (726 )	\$ (2,209 )
Portion of loss recognized in other comprehensive income (loss)	(1,264 )	(14,246 )
Net other-than-temporary credit impairment losses	\$ (1,990 )	\$ (16,455 )

	For the Nine Months Ended	
	September 30, 2014	September 30, 2013
	(dollars in thousands)	
Total other-than-temporary impairment losses	\$ (4,939 )	\$ (2,209 )
Portion of loss recognized in other comprehensive income (loss)	(3,932 )	(20,409 )
Net other-than-temporary credit impairment losses	\$ (8,871 )	\$ (22,618 )

The following table presents a roll forward of the credit loss component of OTTI on the Company's Non-Agency RMBS for which a portion of loss was previously recognized in OCI. The table delineates between those securities that are recognizing OTTI for the first time as opposed to those that have previously recognized OTTI.

	For the Quarter Ended	
	September 30, 2014	September 30, 2013
	(dollars in thousands)	
Cumulative credit loss beginning balance	\$ 512,583	\$ 498,252
Additions:		
Other-than-temporary impairments not previously recognized	1,322	15,837
Reductions for securities sold or deconsolidated during the period	(48,970 )	(2,919 )
Increases related to other-than-temporary impairments on securities with previously recognized other-than-temporary impairments	668	618
Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security	(688 )	(4,536 )
Cumulative credit loss ending balance	\$ 464,915	\$ 507,252

	For the Nine Months Ended	
	September 30, 2014	September 30, 2013
	(dollars in thousands)	
Cumulative credit loss beginning balance	\$ 524,432	\$ 510,089
Additions:		
Other-than-temporary impairments not previously recognized	8,203	16,549
Reductions for securities sold or deconsolidated during the period	(61,854 )	(14,038 )
Increases related to other-than-temporary impairments on securities with previously recognized other-than-temporary	668	6,069

impairments

Reductions for increases in cash flows expected to be collected over the remaining life of the securities	(6,534 )	(11,417 )
Cumulative credit impairment loss ending balance	\$ 464,915	\$ 507,252

Cash flows generated to determine net other-than-temporary credit impairment losses recognized in earnings are estimated using significant unobservable inputs. The significant inputs used to measure the component of OTTI recognized in earnings for the Company's Non-Agency RMBS are summarized as follows:

	For the Nine Months Ended	
	September 30, 2014	September 30, 2013
<b>Loss Severity</b>		
Weighted Average	72%	55%
	35% -	41% -
Range	91%	75%
<b>60+ days delinquent</b>		
Weighted Average	33%	23%
	8% -	0% -
Range	47%	37%
<b>Credit Enhancement (1)</b>		
Weighted Average	10%	5%
	0% -	0% -
Range	35%	48%
<b>3 Month CPR</b>		
Weighted Average	8%	18%
	2% -	0% -
Range	25%	42%
<b>12 Month CPR</b>		
Weighted Average	10%	18%
	5% -	9% -
Range	22%	35%

(1) Calculated as the combined credit enhancement to the Re-REMIC and underlying from each of their respective capital structures.

The following tables present a summary of unrealized gains and losses at September 30, 2014 and December 31, 2013. IO RMBS included in the tables below represent the right to receive a specified proportion of the contractual interest cash flows of the underlying principal balance of specific securities. At September 30, 2014, IO RMBS had a net unrealized loss of \$34 million and had an amortized cost of \$370 million. At December 31, 2013, IO RMBS had a net unrealized loss of \$49 million and had an amortized cost of \$349 million. The fair value of IOs at September 30, 2014 and December 31, 2013 was \$336 million, and \$300 million, respectively. All changes in fair value of IOs are reflected in Net income (loss).

September 30, 2014 (dollars in thousands)					
Gross Unrealized Gain Included in Accumulated	Gross Unrealized Gain Included in	Total Gross Unrealized Gain	Gross Unrealized Loss Included in Accumulated	Gross Unrealized Loss Included in Accumulated	Total Gross Unrealized Loss

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

	Other Comprehensive Income	Accumulated Deficit		Other Comprehensive Income	Deficit	
<b>Non-Agency RMBS</b>						
Senior	\$ 26,534	\$ -	\$ 26,534	\$ (550 )	\$ -	\$ (550 )
Senior, interest-only	-	13,905	13,905	-	(45,112 )	(45,112 )
Subordinated	103,988	-	103,988	(497 )	-	(497 )
Subordinated, interest-only	-	207	207	-	(2,724 )	(2,724 )
RMBS transferred to consolidated VIEs	787,775	2,750	790,525	-	-	-
<b>Agency RMBS</b>						
Pass-through	59,685	-	59,685	(31,929 )	-	(31,929 )
Interest-only	-	639	639	-	(3,581 )	(3,581 )
<b>Total</b>	<b>\$ 977,982</b>	<b>\$ 17,501</b>	<b>\$ 995,483</b>	<b>\$ (32,976 )</b>	<b>\$ (51,417 )</b>	<b>\$ (84,393 )</b>

December 31, 2013  
(dollars in thousands)

	Gross Unrealized Gain Included in Accumulated Other Comprehensive Income	Gross Unrealized Gain Included in Accumulated Deficit	Total Gross Unrealized Gain	Gross Unrealized Loss Included in Accumulated Other Comprehensive Income	Gross Unrealized Loss Included in Accumulated Deficit	Total Gross Unrealized Loss
<b>Non-Agency RMBS</b>						
Senior	\$ 974	\$ -	\$ 974	\$ (109 )	\$ -	\$ (109 )
Senior, interest only	-	11,802	11,802	-	(66,008 )	(66,008 )
Subordinated	119,233	-	119,233	(1,896 )	-	(1,896 )
Subordinated, interest only	-	2,483	2,483	-	(578 )	(578 )
RMBS transferred to consolidated VIEs	901,773	4,170	905,943	-	-	-
<b>Agency RMBS</b>						
Pass-through	22,320	-	22,320	(51,494 )	-	(51,494 )
Interest-only	2	330	332	-	(1,316 )	(1,316 )
<b>Total</b>	<b>\$ 1,044,302</b>	<b>\$ 18,785</b>	<b>\$ 1,063,087</b>	<b>\$ (53,499 )</b>	<b>\$ (67,902 )</b>	<b>\$ (121,401)</b>

Changes in prepayments, actual cash flows, and cash flows expected to be collected, among other items, are affected by the collateral characteristics of each asset class. The portfolio is most heavily weighted to contain Non-Agency RMBS with credit risk. The Company chooses assets for the portfolio after carefully evaluating each investment's risk profile.



The following tables provide a summary of the Company's RMBS portfolio at September 30, 2014 and December 31, 2013.

	September 30, 2014					Weighted Average Yield at Period-End (1)
	Principal or Notional Value at Period-End (dollars in thousands)	Weighted Average Amortized Cost Basis	Weighted Average Fair Value	Weighted Average Coupon		
<b>Non-Agency Mortgage-Backed Securities</b>						
Senior	\$ 312,619	\$ 68.46	\$ 76.76	2.4 %		5.5 %
Senior, interest-only	\$ 5,383,454	\$ 4.44	\$ 3.86	1.6 %		15.2 %
Subordinated	\$ 689,332	\$ 48.81	\$ 63.83	3.3 %		10.5 %
Subordinated, interest-only	\$ 218,527	\$ 4.51	\$ 3.36	0.9 %		8.4 %
RMBS transferred to consolidated VIEs	\$ 3,226,298	\$ 54.62	\$ 79.46	4.6 %		17.1 %
<b>Agency Mortgage-Backed Securities</b>						
Pass-through	\$ 7,553,614	\$ 104.96	\$ 105.32	4.0 %		3.1 %
Interest-only	\$ 2,016,717	\$ 5.81	\$ 5.66	1.1 %		3.7 %

(1) Bond Equivalent Yield at period end.

	December 31, 2013					Weighted Average Yield at Period-End (1)
	Principal or Notional Value at Period-End (dollars in thousands)	Weighted Average Amortized Cost Basis	Weighted Average Fair Value	Weighted Average Coupon		
<b>Non-Agency Mortgage-Backed Securities</b>						
Senior	\$ 128,217	\$ 69.27	\$ 69.95	1.4 %		5.9 %
Senior, interest only	\$ 5,742,781	\$ 4.93	\$ 3.99	1.4 %		17.2 %
Subordinated	\$ 830,632	\$ 40.96	\$ 55.09	2.9 %		13.5 %
Subordinated, interest only	\$ 274,462	\$ 5.34	\$ 6.04	1.7 %		9.0 %
RMBS transferred to consolidated VIEs	\$ 3,912,376	\$ 54.17	\$ 77.82	4.7 %		15.8 %
<b>Agency Mortgage-Backed Securities</b>						
Pass-through	\$ 1,898,131	\$ 104.52	\$ 105.24	3.6 %		3.3 %
Interest only	\$ 247,344	\$ 17.69	\$ 17.30	3.2 %		5.3 %

(1) Bond Equivalent Yield at period end.

The following table presents the weighted average credit rating, based on the lowest rating available, of the Company's Non-Agency RMBS portfolio at September 30, 2014 and December 31, 2013.

	September 30, 2014		December 31, 2013	
AAA	0.9	%	0.0	%
AA	0.5	%	0.7	%
A	0.0	%	0.0	%
BBB	0.4	%	0.0	%
BB	1.9	%	1.4	%
B	5.6	%	4.3	%
Below B or not rated	90.7	%	93.6	%
Total	100.0	%	100.0	%

Actual maturities of RMBS are generally shorter than the stated contractual maturities. Actual maturities of the Company's RMBS are affected by the contractual lives of the underlying mortgages, periodic payments of principal and prepayments of principal. The following tables provide a summary of the fair value and amortized cost of the Company's RMBS at September 30, 2014 and December 31, 2013 according to their estimated weighted-average life classifications. The weighted-average lives of the RMBS in the tables below are based on lifetime expected prepayment rates using an industry prepayment model for the Agency RMBS portfolio and the Company's prepayment assumptions for the Non-Agency RMBS. The prepayment model considers current yield, forward yield, steepness of the interest rate curve, current mortgage rates, mortgage rates of the outstanding loan, loan age, margin, and volatility.



September 30, 2014  
(dollars in thousands)

	Weighted Average Life				Total
	Less than one year	Greater than one year and less than five years	Greater than five years and less than ten years	Greater than ten years	
Fair value					
Non-Agency RMBS					
Senior	\$ 2,591	\$ 60,512	\$ 170,527	\$ 6,304	\$ 239,934
Senior interest-only	641	61,272	111,808	34,119	207,840
Subordinated	-	49,171	234,248	156,548	439,967
Subordinated interest-only	-	-	5,929	1,411	7,340
RMBS transferred to consolidated VIEs	-	199,600	1,606,828	721,907	2,528,335
Agency RMBS					
Pass-through	-	7,830,535	88,424	36,846	7,955,805
Interest-only	-	31,795	82,374	-	114,169
Total fair value	\$ 3,232	\$ 8,232,885	\$ 2,300,138	\$ 957,135	\$ 11,493,390
Amortized cost					
Non-Agency RMBS					
Senior	\$ 2,504	\$ 54,965	\$ 154,622	\$ 1,859	\$ 213,950
Senior interest-only	1,395	70,864	129,346	37,442	239,047
Subordinated	-	36,703	170,152	129,621	336,476
Subordinated interest-only	-	-	8,653	1,204	9,857
RMBS transferred to consolidated VIEs	-	143,036	1,119,807	474,967	1,737,810
Agency RMBS					
Pass-through	-	7,805,818	85,390	36,841	7,928,049
Interest-only	-	32,007	85,104	-	117,111
Total amortized cost	\$ 3,899	\$ 8,143,393	\$ 1,753,074	\$ 681,934	\$ 10,582,300

December 31, 2013  
(dollars in thousands)

	Weighted Average Life				Total
	Less than one year	Greater than one year and less than five years	Greater than five years and less than ten years	Greater than ten years	

Fair value					
Non-Agency RMBS					
Senior	\$ -	\$ 29,283	\$ 60,404	\$ -	\$ 89,687
Senior interest-only	376	103,688	96,968	28,033	229,065
Subordinated	3,359	63,177	321,333	69,700	457,569
Subordinated					
interest-only	-	-	14,862	1,709	16,571
RMBS transferred					
to consolidated VIEs	5,724	276,752	1,986,879	712,216	2,981,571
Agency RMBS					
Pass-through	-	20,375	1,808,346	126,075	1,954,796
Interest-only	54	636	42,092	-	42,782
Total fair value	\$ 9,513	\$ 493,911	\$ 4,330,884	\$ 937,733	\$ 5,772,041
Amortized cost					
Non-Agency RMBS					
Senior	\$ -	\$ 28,900	\$ 59,922	\$ -	\$ 88,822
Senior interest-only	1,017	131,159	117,008	34,087	283,271
Subordinated	2,877	50,483	243,350	43,522	340,232
Subordinated					
interest-only	-	-	13,344	1,322	14,666
RMBS transferred					
to consolidated VIEs	4,744	211,925	1,356,981	501,978	2,075,628
Agency RMBS					
Pass-through	-	18,608	1,837,611	127,751	1,983,970
Interest-only	122	825	42,819	-	43,766
Total amortized cost	\$ 8,760	\$ 441,900	\$ 3,671,035	\$ 708,660	\$ 4,830,355

The Non-Agency RMBS portfolio is subject to credit risk. The Company seeks to mitigate credit risk through its asset selection process. The Non-Agency RMBS portfolio is primarily collateralized by what the Company classifies as Alt-A first lien mortgages. An Alt-A mortgage is a type of U.S. mortgage that, for various reasons, is considered riskier than A-paper, or prime, and less risky than subprime, the riskiest category. Alt-A interest rates, which are determined by credit risk, therefore tend to be between those of prime and subprime home loans. Typically, Alt-A mortgages are characterized by borrowers with less than full documentation, lower credit scores and higher loan-to-value ratios. The Company defines Alt-A mortgage securities as non-agency RMBS where (i) the underlying collateral has weighted average FICO scores between 680 and 720 or (ii) for instances where FICO scores are greater than 720, RMBS have 30% or less of the underlying collateral composed of full documentation loans. At September 30, 2014 and December 31, 2013, 65% and 61% of the Non-Agency RMBS collateral was classified as Alt-A, respectively. At September 30, 2014 and December 31, 2013, 24% and 28% of the Non-Agency RMBS collateral was classified as prime, respectively.

The Non-Agency RMBS in the Portfolio have the following collateral characteristics at September 30, 2014 and December 31, 2013.

	September 30, 2014		December 31, 2013	
Weighted average maturity (years)	22.7		24.1	
Weighted average amortized loan to value (1)	67.9 %		69.4 %	
Weighted average FICO (2)	685		710	
Weighted average loan balance (in thousands)	\$ 371		\$ 385	
Weighted average percentage owner occupied	83.1 %		84.0 %	
Weighted average percentage single family residence	65.5 %		65.4 %	
Weighted average current credit enhancement	1.6 %		1.6 %	
Weighted average geographic concentration of top five states	CA	32.8 %	CA	33.4 %
	FL	8.5 %	FL	9.1 %
	NY	7.8 %	NY	7.1 %
	NJ	2.9 %	NJ	3.0 %
	MD	2.7 %	MD	2.7 %

(1) Value represents appraised value of the collateral at the time of loan origination.

(2) FICO as determined at the time of loan origination.

The table below presents the origination year of the underlying loans related to the Company's portfolio of Non-Agency RMBS at September 30, 2014 and December 31, 2013.

Origination Year	September 30, 2014		December 31, 2013	
1999	0.2	%	0.0	%
2000	0.6	%	0.6	%
2001	2.1	%	1.2	%
2002	0.4	%	1.0	%
2003	2.6	%	1.4	%

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

2004	4.0	%	3.6	%
2005	20.0	%	17.8	%
2006	28.5	%	32.2	%
2007	37.8	%	40.1	%
2008	2.2	%	2.1	%
2013	0.9	%	0.0	%
2014	0.7	%	0.0	%
Total	100.0	%	100.0	%

Gross realized gains and losses are recorded in “Net realized gains (losses) on sales of investments” on the Company’s Consolidated Statements of Operations and Comprehensive Income. The proceeds and gross realized gains and gross realized losses from sales of investments for the quarters and nine months ended September 30, 2014 and 2013 are as follows:

	For the Quarter Ended		For the Nine Months Ended	
	September	September	September	September
	30, 2014	30, 2013	30, 2014	30, 2013
	(dollars in thousands)			
Proceeds from sales	\$ 1,683,377	\$ 394,361	\$ 1,816,845	\$ 823,923
Gross realized gains	66,566	18,816	75,056	72,942
Gross realized losses	(2,459 )	-	(6,911 )	(3 )
Net realized gain (loss)	\$ 64,107	\$ 18,816	\$ 68,145	\$ 72,939

Included in the gross realized gains in the table above are exchanges of securities with a fair value of \$89 million where the Company exchanged its investment in a re-remic security for the underlying collateral supporting the group related to the exchanged asset. These exchanges were treated as non-cash sales and purchases and resulted in a realized gain of \$23 million reflected in earnings.

#### 4. Securitized Loans Held for Investment

The Company is considered to be the primary beneficiary of VIEs formed for the purpose of securitizing whole mortgage loans. Refer to Note 8 for additional details regarding the Company’s involvement with VIEs. The securitized loans held for investment are carried at amortized cost or at fair value.

Securitized loans held for investment, net of allowance for loan losses

The prime jumbo securitized loans held for investment for which the Company has not elected the fair value option are carried at amortized cost which is their principal balance outstanding, plus unamortized premiums, less unaccreted discounts and an allowance for loan losses. The following table provides a summary of the changes in the carrying value of these securitized loans held for investment at September 30, 2014 and December 31, 2013:

	For the Nine Months Ended September 30, 2014 (dollars in thousands)	For the Year Ended December 31, 2013
Balance, beginning of period	\$ 783,484	\$ 1,300,131
Purchases	-	-
Principal paydowns	(100,673 )	(507,683 )
Net periodic amortization (accretion)	(4,057 )	(10,763 )
Change to loan loss provision	112	1,799
Balance, end of period	\$ 678,866	\$ 783,484

The following table represents the Company's prime jumbo securitized residential mortgage loans held for investment which are carried at amortized cost at September 30, 2014 and December 31, 2013:

	September 30, 2014	December 31, 2013
(dollars in thousands)		
Securitized loans, at amortized cost	\$ 686,269	\$ 792,547
Less: allowance for loan losses	7,403	9,063
Securitized loans held for investment	\$ 678,866	\$ 783,484

The securitized loan portfolio carried at amortized cost is collateralized by prime, jumbo, first lien residential mortgages of which 41% were originated during 2012, 37% were originated during 2011, 7% during 2010, and the remaining 15% of the loans were originated prior to 2010. A summary of key characteristics of these loans follows.

	September 30, 2014	December 31, 2013
Number of loans	930	1,053
Weighted average maturity (years)	26.7	27.3
Weighted average loan to value (1)	71.6 %	71.7 %
Weighted average FICO (2)	766	766
Weighted average loan balance (in thousands)	\$ 725	\$ 737
Weighted average percentage owner	95.1 %	94.7 %

occupied						
Weighted average percentage single family residence		71.0	%		70.0	%
Weighted average geographic concentration of top five states						
	CA	35.4	%	CA	34.7	%
	VA	5.4	%	VA	5.6	%
	NJ	5.4	%	NY	5.5	%
	MD	5.0	%	NJ	5.1	%
	NY	4.8	%	TX	4.9	%

(1) Value represents appraised value of the collateral at the time of loan origination.

(2) FICO as determined at the time of loan origination.

The following table summarizes the changes in the allowance for loan losses for the securitized mortgage loan portfolio carried at amortized cost at September 30, 2014 and December 31, 2013:

	For the Nine Months Ended September 30, 2014	For the Year Ended December 31, 2013
	(dollars in thousands)	
Balance, beginning of period	\$ 9,063	\$ 11,624
Provision for loan losses	(112 )	(1,799 )
Charge-offs	(1,548 )	(762 )
Balance, end of period	\$ 7,403	\$ 9,063

The Company has established an allowance for loan losses related to jumbo prime securitized loans carried at amortized cost that is composed of a general and specific reserve. The balance in the allowance for loan losses related to the general reserve at September 30, 2014 and December 31, 2013 was \$3 million and \$4 million, respectively. The balance in the allowance for loan losses related to the specific reserve at September 30, 2014 and December 31, 2013 was \$4 million and \$5 million, respectively.

The total unpaid principal balance of impaired loans for which the Company established a specific reserve was \$23 million and \$26 million at September 30, 2014 and December 31, 2013, respectively. The Company's recorded investment in impaired loans for which there is a related allowance for credit losses at September 30, 2014 and December 31, 2013 was \$17 million and \$19 million, respectively. The total unpaid principal balance of non-impaired loans for which the Company established a general reserve was \$651 million and \$750 million at September 30, 2014 and December 31, 2013, respectively. The Company's recorded investment in loans that are not impaired for which there is a related general reserve for credit losses at September 30, 2014 and December 31, 2013 was \$662 million and \$765 million, respectively. Interest income on impaired loans carried at amortized cost is not significant.

The following table summarizes the outstanding principal balance of the jumbo prime loans carried at amortized cost which are 30 days delinquent and greater as reported by the servicer at September 30, 2014 and December 31, 2013.

	30 Days Delinquent	60 Days Delinquent	90+ Days Delinquent	Bankruptcy	Foreclosure	REO	Total
(dollars in thousands)							
September 30, 2014	\$ 1,909	\$ 0	\$ 5,506	\$ 0	\$ 3,814	\$ 473	\$ 11,702
December 31, 2013	\$ 999	\$ 570	\$ 2,087	\$ 473	\$ 7,530	\$ 1,179	\$ 12,838

With the exception of its ability to approve certain loan modifications, the Company is not involved with the servicing or modification of the jumbo prime loans held for investment which are carried at amortized cost. The trustee and servicer of the respective securitization are responsible for servicing and modifying these loans. The Company is required to make certain assumptions in accounting for these loans due to the limitation of information available to the Company. The following table presents the loans that were modified by the servicer during the nine months ended September 30, 2014 and 2013.

	Number of Loans Modified During Period	Unpaid Principal Balance of Modified Loans (Pre- modification)	Unpaid Principal Balance of Modified Loans (Post- modification)	Amortized Cost of Modified Loans	Amortized Cost of Modified Loans For Which There is an Allowance for Loan Losses	Amortized Cost of Modified Loans For Which There is No Allowance for Loan Losses
(dollars in thousands)						
Nine Months Ended						
September 30, 2014	2	\$ 1,139	\$ 1,256	\$ 1,173	\$ 1,173	\$ 0
September 30, 2013	3	\$ 2,349	\$ 2,358	\$ 2,248	\$ 2,248	\$ 0

Loans are modified by the servicer as a method of loss mitigation. Based on the information available, during the quarter ended September 30, 2014, the Company determined that all loans carried at amortized cost which were modified by the servicer were considered TDRs, as defined under GAAP. A TDR is generally any modification of a loan to a borrower that is experiencing financial difficulties, where a lender agrees to terms that are more favorable to

the borrower than are otherwise available in the current market. All loan modifications during the quarters ended September 30, 2014 and 2013 included a reduction of the stated interest rates. Loans modified by the servicer have been individually assessed for impairment and measurement of impairment is based on the excess of the recorded investment in the loan over the present value of the expected cash flows, post modification, discounted at the loan's effective interest rate at inception. In the absence of additional loan modifications by the servicer in future periods that are considered to be TDRs, the \$4 million specific reserve related to TDRs as of September 30, 2014 will be recognized in net income in future periods by way of a decrease in the provision for loan losses. If there are further modifications, the reduction of the cashflow is reflected in the provision for loan losses.

As of September 30, 2014, there were no loans that were modified in the past twelve months and delinquent on scheduled payments.

Securitized loans held for investment, at fair value

The securitized loans held for investment for which the Company has elected the fair value option are carried at fair value. See Note 5 to our Consolidated Financial Statements for a discussion on how we determine the fair values of the securitized loans held for investment. As changes in the fair value of these securitized loans are reflected in earnings, the Company does not estimate or record a loan loss provision.



The following table provides a summary of the changes in the carrying value of securitized loans held for investment for which the Company has elected the fair value option at September 30, 2014 and December 31, 2013:

	From Acquisition to September 30, 2014 (dollars in thousands)
Balance, beginning of period	\$ -
Purchases	4,722,824
Principal paydowns	(44,809 )
Net periodic amortization (accretion)	(484 )
Change in fair value	139,020
Balance, end of period	\$ 4,816,551

The securitized loan portfolio for which the Company has elected fair value option is collateralized by seasoned sub-prime residential mortgages originated during the following years:

Origination Year	September 30, 2014	
2002 and prior	6.1	%
2003	4.4	%
2004	12.4	%
2005	20.6	%
2006	18.1	%
2007	26.2	%
2008	9.9	%
2009	1.2	%
2010 and later	1.1	%
Total	100.0	%

A summary of key characteristics of these loans follows.

	September 30, 2014	
Number of loans	59,447	
Weighted average maturity (years)	6.3	
Weighted average loan to value (1)	80.2	%
Weighted average FICO (1)	629	
Weighted average loan balance (in thousands)	\$ 79,872	
Weighted average percentage owner occupied	95.8	%
	79.3	%

Weighted average percentage single family residence			
Weighted average geographic concentration of top five states			
	CA	9.3	%
	FL	7.0	%
	NC	7.0	%
	VA	6.4	%
	OH	6.0	%

(1) As provided by the Trustee

The following table summarizes the outstanding principal balance of loans carried at fair value which are 30 days delinquent and greater as reported by the servicer at September 30, 2014.

	30 Days Delinquent	60 Days Delinquent	90+ Days Delinquent	Bankruptcy	Foreclosure	REO	Total
	(dollars in thousands)						
September 30, 2014	\$155,898	\$66,793	\$114,221	\$292,983	\$72,897	\$12,710	\$715,502

The fair value of the loans 90 days or more past due is \$80 million. The fair value of REO assets is \$6 million and is recorded in Other assets of consolidated VIEs.

## 5. Fair Value Measurements

The Company follows fair value guidance in accordance with GAAP to account for its financial instruments. The Company categorizes its financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. Financial assets and liabilities recorded at fair value on the Consolidated Statements of Financial Condition or disclosed in the related notes are categorized based on the inputs to the valuation techniques as follows:

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

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

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

Fair value measurements categorized within Level 3 are sensitive to changes in the assumptions or methodology used to determine fair value and such changes could result in a significant increase or decrease in the fair value. Any changes to the valuation methodology are reviewed by management to ensure the changes are appropriate. As markets and products evolve and the pricing for certain products becomes more transparent, the Company will continue to refine its valuation methodologies. The methodology utilized by the Company for the periods presented is unchanged. The methods used to produce a fair value calculation may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. The Company uses inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced.

During times of market dislocation, as has been experienced for some time and continues to exist, the observability of prices and inputs can be difficult for certain investments. If third party pricing services are unable to provide a price for an asset, or if the price provided by them is deemed unreliable by the Company, then the asset will be valued at its fair value as determined by the Company without validation to third-party pricing. Illiquid investments typically experience greater price volatility as an active market does not exist. Observability of prices and inputs can vary significantly from period to period and may cause instruments to change classifications within the three level hierarchy.

A description of the methodologies utilized by the Company to estimate the fair value of its financial instruments by instrument class follows:

### Agency and Non-Agency RMBS

For each reporting period, the Company determines the fair value of its investment securities based on discounted cash flows utilizing an internal pricing model that incorporates factors such as coupon, prepayment speeds, weighted average life, collateral composition, borrower characteristics, expected interest rates, life caps, periodic caps, reset dates, collateral seasoning, expected losses, expected default severity, credit enhancement, and other pertinent factors. The Company reviews the fair values generated by the model to determine whether prices are reflective of the current market by corroborating its estimates of fair value by comparing the results to non-binding independent prices provided by two independent third party pricing services for all securities. For certain highly liquid asset classes, such as Agency fixed-rate pass-throughs, the Company's valuations are also compared to quoted prices for To-Be-Announced ("TBA") securities.

Each quarter the Company develops thresholds which are determined utilizing current bid/ask spreads, liquidity, price volatility and other factors as appropriate. If internally developed prices differ from the independent prices provided by greater than a predetermined threshold for the period, the Company highlights these differences for further review, both internally and with the third party pricing service. The Company obtains the inputs used by the third party pricing services and compares them to the Company's inputs. The Company updates its own inputs if the Company determines the third party pricing inputs more accurately reflect the current market environment. If the Company believes that its internally developed inputs more accurately reflect the current market environment, it will request that the third party pricing service review market factors that may not have been considered by the third party pricing service. The Company reconciles and resolves all pricing differences in excess of the predetermined thresholds before a final price is established.

The Company's estimate of prepayment, default and severity curves all involve management judgment and assumptions that are deemed to be significant to the fair value measurement process, which renders the resulting Non-Agency RMBS fair value estimates Level 3 inputs in the fair value hierarchy.

### Securitized Loans Held for Investment

The Company estimates the fair value of its securitized loans held for investment on a loan by loan basis using an internally developed model which compares the loan held by the Company with a loan currently offered in the market. The loan price is adjusted in the model by considering the loan factors which would impact the value of a loan. These loan factors include: loan coupon as compared to coupon currently available in the market, FICO, loan-to-value ratios, delinquency history, owner occupancy, and property type, among other factors. The Company develops a baseline for each significant loan factor and adjusts the price up or down depending on how that factor for each specific loan compares to the baseline rate. Generally, the most significant impact on loan value is the loan interest rate as compared to interest rates currently available in the market and delinquency history. These two factors are based on relevant observable inputs.

The Company also monitors market activity to identify trades which may be used to compare internally developed prices; however, as the portfolio of loans held at fair value by the Company is a seasoned sub-prime pool of mortgage loans, comparables are not common or directly comparable. There are limited transactions in the marketplace to develop a comprehensive direct range of values. However, if market data becomes available, the Company will compare this data to the internally developed prices to ensure reasonableness of the valuation.

The Company reviews the fair values generated by the model to determine whether prices are reflective of the current market by corroborating its estimates of fair value by comparing the results to non-binding independent prices provided by two independent third party pricing services for the loan portfolio.

If the internally developed fair value of the loan pools differ from the independent prices provided by greater than a predetermined threshold for the period, the Company highlights these differences for further review, both internally and with the third party pricing service. The Company obtains certain inputs used by the third party pricing services and evaluates them for reasonableness. The Company updates its own model if the Company determines the third party pricing inputs more accurately reflect the current market environment or observed information from the third party vendors. If the Company believes that its internally developed inputs more accurately reflect the current market environment, it will request that the third party pricing service review market factors that may not have been considered by the third party pricing service. The Company reconciles and resolves all pricing differences in excess of the predetermined thresholds before a final price is established.

The Company's estimates of fair value of securitized loans held for investment involve management judgements and assumptions that are deemed to be significant to the fair value measurement process, which renders the resulting fair value estimates Level 3 inputs in the fair value hierarchy.

Securitized Debt, collateralized by Non-Agency RMBS Transferred to Consolidated VIEs and Securitized Debt, Loans Held for Investment at cost

The Company records securitized debt for certificates or notes financed without recourse to the Company in securitization or re-securitization transactions treated as secured borrowings. The Company carries securitized debt at the principal balance outstanding plus unamortized premiums, less unaccreted discounts recorded in connection with the financing of the loans or RMBS with third parties. The premiums or discounts associated with the financing of the notes or certificates are amortized over the contractual life of the instrument using the interest method. The Company estimates the fair value of securitized debt by estimating the future cash flows associated with the underlying assets collateralizing the secured debt outstanding. The Company models the fair value of each underlying asset by considering, among other items, the structure of the underlying security, coupon, servicer, actual and expected defaults, actual and expected default severities, reset indices, and prepayment speeds in conjunction with market research for similar collateral performance and management's expectations of general economic conditions in the sector and other economic factors.

Securitized Debt, collateralized by Loans Held for Investment at fair value

The Company records securitized debt for certificates or notes financed without recourse to the Company in securitization or re-securitization transactions treated as secured borrowings. The Company carries certain securitized debt at fair value. The Company estimates the fair value of this securitized debt consistent with non-agency RMBS by estimating the future cash flows associated with the underlying assets collateralizing the secured debt outstanding. The Company models the fair value of each underlying asset by considering, among other items, the structure of the underlying security, coupon, servicer, actual and expected defaults, actual and expected default severities, reset indices, and prepayment speeds in conjunction with market research for similar collateral performance and management's expectations of general economic conditions in the sector and other economic factors.

See the further discussion of the valuation process and benchmarking process in the Agency and Non-Agency RMBS discussion of fair value.

The Company's estimates of fair value of Securitized debt, collateralized by loans held for investment at fair value involve management judgements and assumptions that are deemed to be significant to the fair value measurement process, which renders the resulting fair value estimates Level 3 inputs in the fair value hierarchy.

## Derivatives

### Interest Rate Swaps

The Company determines the fair value of its interest rate swaps based on the net present value of future cash flows of the swap. The Company compares its own estimate of fair value to dealer quotes received to evaluate for reasonableness. The dealer quotes incorporate common market pricing methods, including a spread measurement to the Treasury yield curve or interest rate swap curve as well as underlying characteristics of the particular contract. Interest rate swaps are modeled by the Company by incorporating such factors as the term to maturity, Treasury curve, overnight index swap rates, and the payment rates on the fixed portion of the interest rate swaps. The Company has classified the characteristics used to determine the fair value of interest rate swaps as Level 2 inputs in the fair value hierarchy.

### Mortgage Options

Mortgage options are valued using an option pricing model which considers the strike price of the option, the price of the underlying security, settle date, a discount rate and the implied volatility. The implied volatility is determined from the daily price of the underlying security as well as prices on similar financial instruments. The Company has classified the characteristics used to determine the fair value of mortgage options as Level 3 inputs in the fair value hierarchy.

#### Treasury Futures

The fair value of Treasury futures is determined by quoted market prices for similar financial instruments in an active market. The Company has classified the characteristics used to determine the fair value of Treasury futures as Level 1 inputs in the fair value hierarchy.

## Repurchase Agreements

Repurchase agreements are collateralized financing transactions utilized by the Company to acquire investment securities. Due to the short term nature of these financial instruments, the Company estimates the fair value of these repurchase agreements using the contractual obligation plus accrued interest payable at maturity.

## Short-term Instruments

The carrying value of cash and cash equivalents, accrued interest receivable, receivable for securities, dividends payable, payable for securities and accrued interest payable are considered to be a reasonable estimate of fair value due to the short term nature of these financial instruments.

The Company's financial assets and liabilities carried at fair value on a recurring basis, including the level in the fair value hierarchy, at September 30, 2014 and December 31, 2013 is presented below.

	September 30, 2014 (dollars in thousands)			Counterparty and Cash Collateral, netting	Total
	Level 1	Level 2 (dollars in thousands)	Level 3		
<b>Assets:</b>					
<b>Non-Agency RMBS</b>					
Senior	\$ -	\$ -	\$ 239,934	\$ -	\$ 239,934
Senior interest-only	-	-	207,840	-	207,840
Subordinated	-	-	439,967	-	439,967
Subordinated interest-only	-	-	7,340	-	7,340
RMBS transferred to consolidated VIEs	-	-	2,528,335	-	2,528,335
Securitized loans held for investment, at fair value	-	-	4,816,551	-	4,816,551
<b>Agency RMBS</b>					
Pass-through	-	7,955,805	-	-	7,955,805
Interest-only	-	114,169	-	-	114,169
<b>Other Derivatives</b>					
<b>Liabilities:</b>					
Securitized debt at fair value, collateralized by loans held for investment	-	-	(3,737,602)	-	(3,737,602)
Derivatives, net	7,800	(38,012)	-	21,790	(8,422)
Total	\$ 7,800	\$ 8,031,962	\$ 4,502,365	\$ 21,790	\$ 12,563,917

	December 31, 2013 (dollars in thousands)			Counterparty and Cash	Total
	Level 1	Level 2	Level 3		



	(dollars in thousands)			Collateral, netting	
<b>Assets:</b>					
<b>Non-Agency RMBS</b>					
Senior	\$ -	\$ -	\$ 89,687	\$ -	\$ 89,687
Senior interest-only	-	-	229,065	-	229,065
Subordinated	-	-	457,569	-	457,569
Subordinated interest-only	-	-	16,571	-	16,571
RMBS transferred to consolidated VIEs	-	-	2,981,571	-	2,981,571
<b>Agency RMBS</b>					
Pass-through	-	1,954,796	-	-	1,954,796
Interest-only	-	42,782	-	-	42,782
Derivatives, net	10,629	-	-	(2,534 )	8,095
<b>Liabilities:</b>					
Derivatives, net	-	(30,199 )	-	-	(30,199 )
<b>Total</b>	<b>\$ 10,629</b>	<b>\$ 1,967,379</b>	<b>\$ 3,774,463</b>	<b>\$ (2,534 )</b>	<b>\$ 5,749,937</b>

The table below provides a summary of the changes in the fair value of securities classified as Level 3 at September 30, 2014 and December 31, 2013.

Fair Value Reconciliation, Level 3

For the Nine Months Ended  
September 30, 2014  
(dollars in thousands)

	Non-Agency RMBS	Derivatives	Securitized Loans	Securitized Debt	Total
Beginning balance Level 3 assets	\$3,774,463	\$-	\$-	\$-	\$3,774,463
Transfers in to Level 3 assets	-	-	-	-	-
Transfers out of Level 3 assets	-	-	-	-	-
Purchases	405,994	-	4,722,824	(4,033,304)	1,095,514
Principal payments	(247,106 )	-	(44,809 )	266,198	(25,717 )
Sales and Settlements	(600,511 )	(8,749 )	-	-	(609,260 )
Accretion (amortization) of purchase discounts	74,461	-	(484 )	4	73,981
Gains (losses) included in net income					
Other than temporary credit impairment losses	(8,871 )	-	-	-	(8,871 )
Realized gains (losses) on sales and settlements	62,558	8,749	-	-	71,307
Realized gain on deconsolidation	47,846	-	-	-	47,846
Net unrealized gains (losses) included in income	17,158	-	139,020	29,500	185,678
Gains (losses) included in other comprehensive income					
Total unrealized gains (losses) for the period	(102,576 )	-	-	-	(102,576 )
Ending balance Level 3 assets	\$3,423,416	\$-	\$4,816,551	\$(3,737,602)	\$4,502,365

Fair Value Reconciliation, Level 3

For the Year Ended  
December 31, 2013  
(dollars in thousands)

	Non-Agency RMBS	Derivatives	Securitized Loans	Securitized Debt	Total
Beginning balance Level 3 assets	\$3,961,208	-	-	-	\$3,961,208
Transfers in to Level 3 assets	-	-	-	-	-
Transfers out of Level 3 assets	-	-	-	-	-
Purchases	317,299	-	-	-	317,299
Principal payments	(475,092 )	-	-	-	(475,092 )
Sales and Settlements	(181,215 )	(10,221 )	-	-	(191,436 )
Accretion of purchase discounts	106,290	-	-	-	106,290
Gains (losses) included in net income					

Other than temporary credit impairment losses	(45,167 )	-	-	-	(45,167 )
Realized gains (losses) on sales and settlements	36,645	10,221	-	-	46,866
Realized losses on principal write-downs of Non-Agency RMBS	(18,316 )	-	-	-	(18,316 )
Net unrealized gains (losses) included in income	(43,252 )	-	-	-	(43,252 )
Gains (losses) included in other comprehensive income					
Total unrealized gains (losses) for the period	116,063	-	-	-	116,063
Ending balance Level 3 assets	\$3,774,463	\$-	\$-	\$-	\$3,774,463

There were no transfers to or from Level 3 for the nine months ended September 30, 2014 and for year ended December 31, 2013.

#### Sensitivity of Significant Inputs – Non-agency RMBS and securitized debt carried at fair value

The significant unobservable inputs used in the fair value measurement of the Company's Non-Agency RMBS and securitized debt carried at fair value are the weighted average discount rates, constant prepayment speed ("CPR"), cumulative default rate, and the loss severity.

Prepayment speeds, as reflected by the CPR, vary according to interest rates, the type of financial instrument, conditions in financial markets, and other factors, none of which can be predicted with any certainty. In general, when interest rates rise, it is relatively less attractive for borrowers to refinance their mortgage loans, and as a result, prepayment speeds tend to decrease. When interest rates fall, prepayment speeds tend to increase. For RMBS investments purchased at a premium, as prepayment speeds increase, the amount of income the Company earns decreases as the purchase premium on the bonds amortizes faster than expected. Conversely, decreases in prepayment speeds result in increased income and can extend the period over which the Company amortizes the purchase premium. For RMBS investments purchased at a discount, as prepayment speeds increase, the amount of income the Company earns increases from the acceleration of the accretion of the discount into interest income. Conversely, decreases in prepayment speeds result in decreased income as the accretion of the purchase discount into interest income occurs over a longer period.

For securitized debt carried at fair value issued at a premium, as prepayment speeds increase, the amount of interest expense the Company recognizes decreases as the issued premium on the debt amortizes faster than expected. Conversely, decreases in prepayment speeds result in decreased income and can extend the period over which the Company amortizes the premium.

For debt issued at a discount, as prepayment speeds increase, the amount of interest the Company expenses increases from the acceleration of the accretion of the discount into interest expense. Conversely, decreases in prepayment speeds result in decreased expense as the accretion of the discount into interest expense occurs over a longer period.

Cumulative default rates represent an annualized rate of default on a group of mortgages. The constant default rate (“CDR”) represents the percentage of outstanding principal balances in the pool that are in default, which typically equates to the home being past 60-day and 90-day notices and in the foreclosure process. When default rates increase, expected cash flows on the underlying collateral decreases. When default rates decrease, expected cash flows on the underlying collateral increases.

Loss severity rates reflect the amount of loss expected from a foreclosure and liquidation of the underlying collateral in the mortgage loan pool. When a mortgage loan is foreclosed the collateral is sold and the resulting proceeds are used to settle the outstanding obligation. In many circumstances, the proceeds from the sale do not fully repay the outstanding obligation. In these cases a loss is incurred by the lender. Loss severity is used to predict how costly future losses are likely to be. An increase in loss severity results in a decrease in expected future cashflows. A decrease in loss severity results in an increase in expected future cashflows.

The discount rate refers to the interest rate used in the discounted cash flow analysis to determine the present value of future cash flows. The discount rate takes into account not just the time value of money, but also the risk or uncertainty of future cash flows. An increased uncertainty of future cash flows results in a higher discount rate. The discount rate used to calculate the present value of the expected future cash flows is based on the discount rate implicit in the security as of the last measurement date. As discount rates move up, the discounted cash flows are reduced.

A summary of the significant inputs used to estimate the fair value of Non-Agency RMBS held for investment at fair value as of September 30, 2014 and December 31, 2013 follows:

	September 30, 2014 Significant Inputs				December 31, 2013 Significant Inputs			
	Weighted Average Discount Rate	CPR	CDR Range	Loss Severity	Weighted Average Discount Rate	CPR	CDR Range	Loss Severity
Non-Agency RMBS								
Senior	4.8%	1% - 12%	0% - 30%	50% - 85%	6.4%	1% - 6%	0% - 33%	50% - 85%
Senior interest-only	13.4%	1% - 25%	0% - 34%	50% - 85%	14.1%	1% - 28%	0% - 33%	50% - 85%
Subordinated	6.0%	1% - 20%	0% - 20%	50% - 78%	6.1%	1% - 22%	0% - 38%	50% - 85%
Subordinated interest-only	22.0%	1% - 10%	0% - 14%	50% - 66%	12.7%	2% - 13%	0% - 18%	50% - 73%
RMBS transferred to consolidated VIEs	4.6%	1% - 17%	0% - 33%	50% - 85%	5.3%	1% - 20%	0% - 33%	50% - 85%

A summary of the significant inputs used to estimate the fair value of Securitized debt at fair value as of September 30, 2014 follows:

September 30, 2014

	Significant Inputs		
	CPR Range	CDR Range	Loss Severity Range
Securitized debt at fair value, collateralized by loans held for investment	3% - 7%	0% - 9%	50% - 66%

All of the significant inputs listed have some degree of market observability, based on the Company's knowledge of the market, information available to market participants, and use of common market data sources. Collateral default and loss severity projections are in the form of "curves" that are updated quarterly to reflect the Company's collateral cash flow projections. Methods used to develop these projections conform to industry conventions. The Company uses assumptions it considers its best estimate of future cash flows for each respective security.

The discount rates applied to the expected cash flows to determine fair value are derived from a range of observable prices on securities backed by similar collateral. As the market becomes more or less liquid, the availability of these observable inputs will change.

The prepayment speed specifies the percentage of the collateral balance that is expected to prepay at each point in the future. The prepayment speed is based on factors such as collateral FICO score, loan-to-value ratio, debt-to-income ratio, and vintage on a loan level basis and is scaled up or down to reflect recent collateral-specific prepayment experience as obtained from remittance reports and market data services.

Default vectors are determined from the current “pipeline” of loans that are more than 30 days delinquent, in foreclosure, bankruptcy, or are REO. These delinquent loans determine the first 30 months of the default curve. Beyond month 30, the default curve transitions to a value that is reflective of a portion of the current delinquency pipeline.

The curve generated to reflect the Company’s expected loss severity is based on collateral-specific experience with consideration given to other mitigating collateral characteristics. Characteristics such as seasoning are taken into consideration because severities tend to initially increase on newly originated securities, before beginning to decline as the collateral ages and eventually stabilize. Collateral characteristics such as loan size, loan-to-value, and geographic location of collateral also effect loss severity.

Sensitivity of Significant Inputs – Securitized loans held for investment at fair value

The significant unobservable inputs used to estimate the fair value of the securitized loans held for investment, at fair value, as of September 30, 2014 include coupon, FICO score, loan-to-value ratios (LTV), owner occupancy status, and property type. A summary of the significant inputs used to estimate the fair value of Securitized loans held for investment at fair value as of September 30, 2014 follows:

	September 30, 2014 Significant Inputs		Weighted Average/Percent of loan pool	
	Base Rate			
<b>Factor:</b>				
<b>Coupon</b>				
Clean	4.63	%	7.07	%
Reperforming	5.50	%	6.98	%
<b>FICO</b>				
	620		629	
<b>Loan-to-value (LTV)</b>				
	90	%	80	%
<b>Occupancy</b>				
Owner Occupied	N/A		96	%
Investor	N/A		4	%
Secondary	N/A		0	%
<b>Property Type</b>				
Single family	N/A		79	%
Manufactured housing	N/A		15	%
Multi-family/mixed use/other	N/A		6	%

The loan factors are generally not observable for the individual loans and the base rates developed by the Company’s internal model are subjective and change as market conditions change. The impact of the loan coupon on the value of the loan is dependent on whether the loan is clean or reperforming. A clean loan, with no history of delinquent

payments and a relatively high loan interest rate would result in a higher overall value than a reperforming loan which has a history of delinquency. Similarly, a higher FICO score and a lower LTV ratio results in increases in the fair market value of the loan and a lower FICO score and a higher LTV ratio would result in a lower value.

Property types also affect the overall loan values. Property types include single family, manufactured housing and multi-family/mixed use and other types of properties. Single family homes represent properties which house only one family unit. Manufacture homes include mobile homes and modular homes. Loan value for properties that are investor or secondary homes have a reduced value as compared to the baseline loan value. Additionally, single family homes will result in an increase to the loan value where manufactured and multi-family/mixed use and other properties will result in a decrease to the loan value, as compared to the baseline.

The following table presents the carrying value and fair value, as described above, of the Company's financial instruments not carried at fair value on a recurring basis at September 30, 2014 and December 31, 2013.

September 30, 2014 (dollars in thousands)			
	Level in Fair Value Hierarchy	Carrying Amount	Fair Value
Securitized loans held for investment	3	678,866	672,953
Repurchase agreements	2	(7,838,163)	(7,850,598)
Securitized debt, collateralized by Non-Agency RMBS	3	(742,894 )	(748,319 )
Securitized debt, collateralized by loans held for investment	3	(572,742 )	(560,663 )
December 31, 2013 (dollars in thousands)			
	Level in Fair Value Hierarchy	Carrying Amount	Fair Value
Securitized loans held for investment	3	783,484	762,550
Repurchase agreements	2	(1,658,561)	(1,660,941)
Securitized debt, collateralized by Non-Agency RMBS	3	(933,732 )	(940,712 )
Securitized debt, collateralized by loans held for investment	3	(669,981 )	(647,628 )

## 6. Repurchase Agreements

The Company had outstanding \$7.8 billion and \$1.7 billion of repurchase agreements with weighted average borrowing rates of 0.57% and 0.44% and weighted average remaining maturities of 67 days and 58 days as of September 30, 2014 and December 31, 2013, respectively. At September 30, 2014 and December 31, 2013, Agency RMBS pledged as collateral under these repurchase agreements had an estimated fair value of \$7.1 billion and \$1.7 billion, respectively. At September 30, 2014, Non-Agency RMBS pledged as collateral under these repurchase agreements had an estimated fair value of \$1.4 billion. There were no Non-Agency RMBS pledged as collateral at December 31, 2013. The average daily balances of the Company's repurchase agreements for the quarters ended September 30, 2014 and December 31, 2013 were \$7.7 billion and \$1.5 billion, respectively. The interest rates of these repurchase agreements are generally indexed to the one-month or the three-month LIBOR rate and re-price accordingly.



Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

At September 30, 2014 and December 31, 2013, the repurchase agreements collateralized by RMBS had the following remaining maturities.

	September 30, 2014	December 31, 2013
	(dollars in thousands)	
Overnight	\$ -	\$ -
1-29 days	3,556,708	644,332
30 to 59 days	1,691,671	606,945
60 to 89 days	957,222	-
90 to 119 days	556,406	129,049
Greater than or equal to 120 days	1,076,156	278,235
<b>Total</b>	<b>\$ 7,838,163</b>	<b>\$ 1,658,561</b>

At September 30, 2014 and December 31, 2013, the Company did not have any amount at risk under its repurchase agreements greater than 10% of its equity with any counterparty.

## 7. Securitized Debt

All of the Company's securitized debt is collateralized by residential mortgage loans or Non-Agency RMBS. For financial reporting purposes, the Company's securitized debt is accounted for as secured borrowings. Thus, the residential mortgage loans or RMBS held as collateral are recorded in the assets of the Company as securitized loans held for investment or Non-Agency RMBS transferred to consolidated VIEs and the securitized debt is recorded as a non-recourse liability in the accompanying Consolidated Statements of Financial Condition.

At September 30, 2014 and December 31, 2013 the Company's securitized debt collateralized by loans held for investment had a principal balance of \$4.4 billion and \$670 million, respectively of which \$3.8 billion as of September 30, 2014, are securitized debt for which the Company has elected the fair value option with changes in fair value reflected in earnings. During the quarter ended September 30, 2014, the company recognized a gain of \$30 million on the securitized debt carried at fair value in Net unrealized gains (losses) on financial instruments at fair value. At September 30, 2014 and December 31, 2013 the total securitized debt collateralized by loans held for investment carried a weighted average cost of financing equal to 3.49% and 3.31% respectively. The debt matures between the years 2023 and 2065.

At September 30, 2014 and December 31, 2013 the Company's securitized debt collateralized by Non-Agency RMBS had a principal balance of \$769 million and \$966 million, respectively. At September 30, 2014 and December 31, 2013, the debt carried a weighted average cost of financing equal to 4.27% and 4.26%, respectively. The debt matures between the years 2035 and 2047.

During the first quarter of 2014, the Company acquired securitized debt collateralized by Non-Agency RMBS with an outstanding principal balance of \$54 million for \$56 million in cash. This transaction resulted in a loss on the extinguishment of debt of \$2 million. This loss is reflected in earnings for the nine months ended September 30, 2014.

During the third quarter of 2014, the Company settled debt collateralized by loans held for investment with an outstanding principal balance of \$220 million for \$220 million in cash. As the debt was carried at and settled at par, no gain or loss was recognized.

The carrying value of securitized debt collateralized by jumbo prime loans is based on its amortized cost, net of premiums or discounts related to sales of senior certificates to third parties. The carrying value of securitized debt collateralized by seasoned sub-prime residential mortgage loans with a weighted average FICO score of 629 is based on fair value. The following table presents the estimated principal repayment schedule of the securitized debt at September 30, 2014 and December 31, 2013, based on expected cash flows of the residential mortgage loans or RMBS, as adjusted for projected losses on the underlying collateral of the debt. All of the securitized debt recorded in the Company's Consolidated Statements of Financial Condition is non-recourse to the Company.

	September 30, 2014	December 31, 2013
	(dollars in thousands)	
Within One Year	\$ 858,050	\$ 370,250
One to Three Years	1,346,397	497,943
Three to Five Years	910,604	264,456
Greater Than Five Years	1,811,101	396,916
<b>Total</b>	<b>\$ 4,926,152</b>	<b>\$ 1,529,565</b>

Maturities of the Company's securitized debt are dependent upon cash flows received from the underlying loans. The estimate of their repayment is based on scheduled principal payments on the underlying loans. This estimate will differ from actual amounts to the extent prepayments and/or loan losses are experienced. See Notes 3 and 4 for a more detailed discussion of the securities and loans collateralizing the securitized debt.

#### 8. Consolidated Securitization Vehicles and Other Variable Interest Entities

Since its inception, the Company has created VIEs for the purpose of securitizing whole mortgage loans or re-securitizing RMBS and obtaining permanent, non-recourse term financing. The Company evaluated its interest in each VIE to determine if it is the primary beneficiary.

As of September 30, 2014, the Company's Consolidated Statements of Financial Condition includes consolidated VIEs with \$8.0 billion of assets and \$5.1 billion of liabilities. As of December 31, 2013, the Company's Consolidated Statements of Financial Condition includes consolidated VIEs with \$3.8 billion of assets and \$1.6 billion of liabilities.

## VIE Activity:

## SLFMT Trusts

During the third quarter of 2014, the Company acquired the rights to approximately \$4.8 billion of seasoned sub-prime residential mortgage loans through the purchase of certain subordinate notes and trust certificates in Springleaf Mortgage Loan Trusts 2011-1, 2012-1, 2012-2, 2012-3, 2013-1, 2013-2 and 2013-3 (“SLFMT Trusts”). By purchasing these securities, the Company may over time, at its option, terminate the SLFMT Trusts by redeeming all outstanding bonds at par and obtain the underlying mortgage collateral in accordance with each respective trust indenture. The Company evaluated the SLFMT Trusts and determined that the total equity investment at risk is not sufficient to permit these trusts to finance its activities without additional subordinated financial support provided by another party. Therefore, the Company concluded that the SLFMT Trusts were VIEs. The Company further determined that their interests in the SLFMT Trusts gave the Company the power to direct the activity of these VIEs that most significantly impacted their economic performance of the VIEs. Therefore, the Company concluded that it was the primary beneficiary of the SLFMT Trusts and consolidated the assets and liabilities of the SLFMT Trusts. The Company eliminated all intercompany interests. The consolidation of the SLFMT Trusts resulted in the addition of the following amounts, net of eliminations, at the time of acquisition.

	SLFMT Trusts (dollars in thousands)
<b>Assets</b>	
Securitized loans held for investment, at fair value	\$ 4,722,825
Other Assets	84,830
<b>Liabilities</b>	
Securitized debt at fair value	\$ 4,033,304

During the third quarter of 2014, the Company transferred its interests in SLFMT 2011-1 to a dealer and entered into a forward trade with the dealer to repurchase all securities of the new securitization entity backed by the collateral of SLFMT 2011-1. The financing for this transaction is reflected as a payable for securities of \$348 million at the end of the third quarter of 2014. This transfer and commitment of repurchase is reflected as financing for GAAP presentation.

## CSMC 2010-12R/CSMC 2014-4R

During the first quarter of 2014, the Company sold all of its interests in CSMC 2010-12R, a consolidated VIE, to an unrelated third party. Subsequent to this sale, the purchaser of the interests in this VIE liquidated the VIE and took possession of the underlying securities of the original VIE for the purposes of creating a new re-securitization entity. The Company agreed to acquire certain interests in the new re-securitization entity, CSMC 2014-4R, collateralized by the underlying securities of the original VIE. These new interests acquired by the Company were evaluated for consolidation under GAAP. The Company determined that the acquired interests in the new re-securitization entity represented variable interests in only specified assets of the new re-securitization entity as these specified assets are essentially the only source of payment for the related variable interests of the new re-securitization entity. As the Company acquired 100% of certain classes of the new re-securitization entity, it concluded that it was the primary beneficiary of certain specified assets and interests of the new re-securitization entity for which it owned 100% of the class and, therefore, consolidated the assets and liabilities related only to their interests acquired.

As the Company did not repurchase all of the interests in the new re-securitization entity, a gain of \$48 million was recognized during the second quarter of 2014 related to the sale of its interests in the previously consolidated VIE which were not repurchased by the Company as part of the new re-securitization entity. This gain is presented as a Gain on deconsolidation during the second quarter of 2014.

As of September 30, 2014, the balance sheet includes the underlying assets of the original consolidated VIE the Company agreed to repurchase from the new re-securitization entity; therefore, no gain or loss is recognized on that portion of the transaction. All intercompany balances related to the consolidated interests are eliminated in consolidation.

## VIEs for Which the Company is the Primary Beneficiary

The retained beneficial interests in VIEs for which the Company is the primary beneficiary are typically the subordinated tranches of these re-securitizations and in some cases the Company may hold interests in additional tranches. The table below reflects the assets and liabilities recorded in the Consolidated Statements of Financial Condition related to the consolidated VIEs as of September 30, 2014 and December 31, 2013.

	September 30, 2014	December 31, 2013
(dollars in thousands)		
Assets		
Non-Agency RMBS transferred to consolidated VIEs	\$ 2,528,335	\$ 2,981,571
Securitized loans held for investment, net of allowance for loan losses	678,866	783,484
Securitized loans held for investment, at fair value	4,816,551	-
Accrued interest receivable	40,587	17,173
Other Assets	80,454	6,534
Liabilities		
Securitized debt, collateralized by Non-Agency RMBS	\$ 742,894	\$ 933,732
Securitized debt, collateralized by loans held for investment	572,742	669,981
Securitized debt at fair value, collateralized by loans held for investment	3,737,602	-
Accrued interest payable	16,383	5,278

Income and expense and OTTI amounts related to consolidated VIEs recorded in the Consolidated Statements of Operations and Comprehensive Income (Loss) is presented in the table below.

	For the Quarter Ended	
	September 30, 2014	September 30, 2013
(dollars in thousands)		
Interest income, Assets of consolidated VIEs	\$ 103,742	\$ 91,543
Interest expense, Non-recourse liabilities of VIEs	(28,984 )	(23,494 )
Net interest income	\$ 74,758	\$ 68,049
Total other-than-temporary impairment losses	-	(2,209 )
Portion of loss recognized in other comprehensive income (loss)	(695 )	(13,427 )
Net other-than-temporary credit impairment losses	\$ (695 )	\$ (15,636 )

	For the Nine Months Ended	
	September 30, 2014	September 30, 2013
	(dollars in thousands)	
Interest income, Assets of consolidated VIEs	\$ 274,215	\$ 282,207
Interest expense, Non-recourse liabilities of VIEs	(66,859 )	(75,472 )
Net interest income	\$ 207,356	\$ 206,735
Total other-than-temporary impairment losses	(479 )	(2,209 )
Portion of loss recognized in other comprehensive income (loss)	(4,166 )	(13,562 )
Net other-than-temporary credit impairment losses	\$ (4,645 )	\$ (15,771 )

#### VIEs for Which the Company is Not the Primary Beneficiary

The Company is not required to consolidate VIEs in which it has concluded it does not have a controlling financial interest, and thus is not the primary beneficiary. In such cases, the Company does not have both the power to direct the entities' most significant activities and the obligation to absorb losses or right to receive benefits that could potentially be significant to the VIEs. The Company's investments in these unconsolidated VIEs are carried in Non-Agency RMBS on the Consolidated Statements of Financial Condition and include senior and subordinated bonds issued by the VIEs. The Company's investments in unconsolidated VIEs at September 30, 2014, ranged from less than \$1 million to \$46 million, with an aggregate amount of \$895 million. The Company's investments in unconsolidated VIEs at December 31, 2013, ranged from less than \$1 million to \$42 million, with an aggregate amount of \$793 million. The Company's maximum exposure to loss from these unconsolidated VIEs was \$799 million at September 30, 2014 and \$727 million at December 31, 2013. The maximum exposure to loss was determined as the amortized cost of the unconsolidated VIE, which represents the purchase price of the investment less any unamortized premiums or discounts as of the reporting date.

## 9. Derivative Instruments

In connection with the Company's interest rate risk management strategy, the Company economically hedges a portion of its interest rate risk by entering into derivative financial instrument contracts in the form of interest rate swaps and Treasury futures. The Company's swaps are used to lock in a fixed rate related to a portion of its current and anticipated payments on its repurchase agreements. The Company typically agrees to pay a fixed rate of interest ("pay rate") in exchange for the right to receive a floating rate of interest ("receive rate") over a specified period of time. Treasury futures are derivatives which track the prices of specific Treasury securities and are traded on an active exchange. It is generally the Company's policy to close out any Treasury futures positions prior to taking delivery of the underlying security. The Company uses Treasury futures to lock in prices on the purchase or sale of Agency RMBS and to hedge changes in interest rates on its existing portfolio.

In addition to interest rate swaps, from time to time the Company purchases and sells mortgage options. Mortgage options give the Company the right, but not the obligation, to buy or sell mortgage backed securities at a future date for a fixed price. The Company uses mortgage options to lock in prices on the purchase or sale of Agency RMBS and to enhance investment returns.

The use of derivatives creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the contracts. In the event of a default by the counterparty, the Company could have difficulty obtaining its RMBS or cash pledged as collateral for these derivative instruments. The Company periodically monitors the credit of its counterparties to determine if it is exposed to counterparty credit risk. See Note 14 for further discussion of counterparty credit risk.

The table below summarizes the location and fair value of the derivatives reported in the Consolidated Statements of Financial Condition after counterparty netting and posting of cash collateral as of September 30, 2014 and December 31, 2013.

September 30, 2014

Derivative Instruments	Notional Amount Outstanding	Derivative Assets		Derivative Liabilities	
		Location on Consolidated Statements of Financial Condition	Net Estimated Fair Value/Carrying Value	Location on Consolidated Statements of Financial Condition	Net Estimated Fair Value/Carrying Value
(dollars in thousands)					
Interest Rate Swaps	\$ 3,435,000	Derivatives, at fair value, net	\$ -	Derivatives, at fair value, net	\$ (16,222 )
Mortgage Options	-	Derivatives, at fair value, net	-	Derivatives, at fair value, net	-
Treasury Futures	1,240,000	Derivatives, at fair value, net	7,800	Derivatives, at fair value, net	-
Total	\$ 4,675,000		\$ 7,800		\$ (16,222 )

December 31, 2013

Derivative Assets

Derivative Liabilities



Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Derivative Instruments	Notional Amount Outstanding	Location on Consolidated Statements of Financial Condition (dollars in thousands)	Net Estimated Fair Value/Carrying Value	Location on Consolidated Statements of Financial Condition	Net Estimated Fair Value/Carrying Value
Interest Rate Swaps	\$ 1,355,000	Derivatives, at fair value, net	\$ -	Derivatives, at fair value	\$ (30,199 )
Treasury Futures	550,000	Derivatives, at fair value, net	8,095	Derivatives, at fair value	-
<b>Total</b>	<b>\$ 1,905,000</b>		<b>\$ 8,095</b>		<b>\$ (30,199 )</b>

The effect of the Company's derivatives on the Consolidated Statements of Operations and Comprehensive Income (Loss) is presented below.

		Net gains (losses) on derivatives For the Quarter Ended	
Derivative Instruments	Location on Consolidated Statements of Operations and Comprehensive Income (Loss)	September 30,	September 30,
		2014	2013
(dollars in thousands)			
Interest Rate Swaps	Net unrealized gains (losses) on derivatives	\$ 7,041	\$ 237
Interest Rate Swaps	Net realized gains (losses) on derivatives	(17,132 )	(5,459 )
Mortgage Options	Net unrealized gains (losses) on derivatives	(4,340 )	(198 )
Mortgage Options	Net realized gains (losses) on derivatives	5,852	3,590
Treasury Futures	Net unrealized gains (losses) on derivatives	10,436	(12 )
Treasury Futures	Net realized gains (losses) on derivatives	(11,547 )	(1,522 )
Swaptions	Net unrealized gains (losses) on derivatives	(162 )	-
Swaptions	Net realized gains (losses) on derivatives	(325 )	-
<b>Total</b>		<b>\$ (10,177 )</b>	<b>\$ (3,364 )</b>

		Net gains (losses) on derivatives For the Nine Months Ended	
Derivative Instruments	Location on Consolidated Statements of Operations and Comprehensive Income (Loss)	September 30,	September 30,
		2014	2013
(dollars in thousands)			
Interest Rate Swaps	Net unrealized gains (losses) on derivatives	\$ (8,728 )	\$ 18,817
Interest Rate Swaps	Net realized gains (losses) on derivatives	(34,843 )	(16,380 )
Mortgage Options	Net unrealized gains (losses) on derivatives	-	(198 )
Mortgage Options	Net realized gains (losses) on derivatives	7,504	3,590
Treasury Futures	Net unrealized gains (losses) on derivatives	(2,829 )	(12 )
		(21,029 )	(1,522 )

Treasury	Net realized gains		
Futures	(losses) on derivatives		
	Net unrealized gains		
Swaptions	(losses) on derivatives	(162 )	-
	Net realized gains		
Swaptions	(losses) on derivatives	(325 )	-
Total		\$ (60,412 )	\$ 4,295

The weighted average pay rate on the Company's interest rate swaps at September 30, 2014 was 2.26% and the weighted average receive rate was 0.20%. The weighted average pay rate on the Company's interest rate swaps at December 31, 2013 was 1.81% and the weighted average receive rate was 0.17%.

Certain of the Company's derivative contracts are subject to International Swaps and Derivatives Association Master Agreements or other similar agreements which may contain provisions that grant counterparties certain rights with respect to the applicable agreement upon the occurrence of certain events such as (i) a decline in stockholders' equity in excess of specified thresholds or dollar amounts over set periods of time, (ii) the Company's failure to maintain its REIT status, (iii) the Company's failure to comply with limits on the amount of leverage, and (iv) the Company's stock being delisted from the New York Stock Exchange (NYSE). Upon the occurrence of any one of items (i) through (iv), or another default under the agreement, the counterparty to the applicable agreement has a right to terminate the agreement in accordance with its provisions. Certain of the Company's interest rate swaps are cleared through a registered commodities exchange. Each of the Company's ISDAs and clearing exchange agreements contains provisions under which the Company is required to fully collateralize its obligations under the interest rate swap agreements if at any point the fair value of the swap represents a liability greater than the minimum transfer amount contained within the agreements. The Company is also required to post initial collateral upon execution of certain of its swap transactions. If the Company breaches any of these provisions, it will be required to settle its obligations under the agreements at their termination values, which approximates fair value. Cleared swaps are fair valued using internal pricing models and compared to the exchange market values. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a net liability position at September 30, 2014 is approximately \$56 million including accrued interest, which represents the maximum amount the Company would be required to pay upon termination, which is fully collateralized.

#### 10. Common Stock

During the quarters ended September 30, 2014 and 2013, the Company declared dividends to common shareholders totaling \$92 million, or \$0.09 per share. During the nine months ended September 30, 2014 and 2013, the Company declared dividends to common shareholders totaling \$277 million, or \$0.27 per share.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Earnings per share for the quarters and nine months ended September 30, 2014 and 2013, respectively, are computed as follows:

	For the Quarter Ended	
	September 30, 2014	September 30, 2013
Numerator:		
Net income	\$ 377,580	\$ 67,367
Effect of dilutive securities:	-	-
Dilutive net income available to stockholders	\$ 377,580	\$ 67,367
Denominator:		
Weighted average basic shares	1,027,183,380	1,027,121,439
Effect of dilutive securities	325,500	437,750
Weighted average diluted shares	1,027,508,880	1,027,559,189
Net income per average share attributable to common stockholders - Basic		
	\$ 0.37	\$ 0.07
Net income per average share attributable to common stockholders - Diluted		
	\$ 0.37	\$ 0.07

	For the Nine Months Ended	
	September 30, 2014	September 30, 2013
	(dollars in thousands)	
Numerator:		
Net income	\$ 582,717	\$ 290,375
Effect of dilutive securities:	-	-
Dilutive net income available to stockholders	\$ 582,717	\$ 290,375
Denominator:		
Weighted average basic shares	1,027,218,024	1,027,075,627
Effect of dilutive securities	325,714	506,955
Weighted average dilutive shares	1,027,543,738	1,027,582,582
Net income per average share attributable to common stockholders - Basic		
	\$ 0.57	\$ 0.28
Net income per average share attributable to common stockholders - Diluted		
	\$ 0.57	\$ 0.28



## 11. Accumulated Other Comprehensive Income

The following table presents the changes in the components of Accumulated Other Comprehensive Income (“AOCI”) for the nine months ended September 30, 2014 and 2013:

	September 30, 2014 (dollars in thousands)	
	Unrealized gains (losses) on available- for-sale securities, net	Total Accumulated OCI Balance
Balance as of December 31, 2013	\$ 990,803	\$ 990,803
OCI before reclassifications	63,995	63,995
Amounts reclassified from AOCI	(109,792 )	(109,792 )
Net current period OCI	(45,797 )	(45,797 )
Balance as of September 30, 2014	\$ 945,006	\$ 945,006

	September 30, 2013 (dollars in thousands)	
	Unrealized gains (losses) on available- for-sale securities, net	Total Accumulated OCI Balance
Balance as of December 31, 2012	\$ 989,936	\$ 989,936
OCI before reclassifications	61,836	61,836
Amounts reclassified from AOCI	(50,321 )	(50,321 )
Net current period OCI	11,515	11,515
Balance as of September 30, 2013	\$ 1,001,451	\$ 1,001,451

The following table presents the details of the reclassifications from AOCI for the nine months ended September 30, 2014 and 2013:

	September 30, 2014	September 30, 2013	
Details about Accumulated OCI Components			Affected Line on the Consolidated

Unrealized gains and losses on available-for-sale securities	Amounts	Amounts	Statements Of Operations And Comprehensive Income (Loss)
	Reclassified from Accumulated OCI	Reclassified from Accumulated OCI	
	(dollars in thousands)		
	\$70,817	\$ 72,939	Net realized gains (losses) on sales of investments
	47,846		Realized gain on deconsolidation
	(8,871 )	(22,618 )	Net other-than-temporary credit impairment losses
	\$109,792	\$ 50,321	Income (loss) before income taxes
	-	-	Income taxes
	\$109,792	\$ 50,321	Net of tax

## 12. Long Term Incentive Plan

On January 2, 2008, the Company granted restricted stock awards in the amount of 1,301,000 shares to employees of FIDAC and its affiliates and the Company's independent directors. The awards to the independent directors vested on the date of grant and the awards to FIDAC's employees vest quarterly over a period of 10 years. During the quarters ended September 30, 2014 and 2013, 16 thousand and 26 thousand shares of restricted stock issued by the Company to FIDAC's employees vested, respectively. During the nine months ended September 30, 2014 and 2013, 53 thousand and 80 thousand shares of restricted stock issued by the Company to FIDAC's employees vested, respectively. As of September 30, 2014 there were 214 thousand remaining non-vested shares representing \$650 thousand of total unrecognized compensation costs granted under the long term incentive plan, based on the closing price of the shares at quarter end. That cost is expected to be recognized over a period of approximately 3.25 years.

## 13. Income Taxes

For the quarter ended September 30, 2014, the Company was qualified to be taxed as a REIT under Code Sections 856 through 860. As a REIT, the Company is not subject to federal income tax to the extent that it makes qualifying distributions of taxable income to its stockholders. To maintain qualification as a REIT, the Company must distribute at least 90% of its annual REIT taxable income to its shareholders and meet certain other requirements such as assets it may hold, income it may generate and its shareholder composition. It is generally the Company's policy to distribute to its shareholders all of the Company's taxable income.

The state and local tax jurisdictions for which the Company is subject to tax-filing obligations recognize the Company's status as a REIT, and therefore, the Company generally does not pay income tax in such jurisdictions. The Company may, however, be subject to certain minimum state and local tax filing fees and its TRS's are subject to federal, state, and local taxes. There were no significant income tax expenses for the quarters or nine months ended September 30, 2014 and 2013.

In general, common stock cash dividends declared by the Company will be considered ordinary income to stockholders for income tax purposes. From time to time, a portion of the Company's dividends may be characterized as capital gains or return of capital.

The Company's effective tax rate differs from its combined federal, state and city corporate statutory tax rate primarily due to the deduction of dividend distributions required to be paid under Code Section 857(a).

The Company's 2013, 2012 and 2011 federal, state and local tax returns remain open for examination.

#### 14. Credit Risk and Interest Rate Risk

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

By using derivative instruments and repurchase agreements, the Company is exposed to counterparty credit risk if counterparties to the contracts do not perform as expected. If a counterparty fails to perform on a derivative hedging instrument, the Company's counterparty credit risk is equal to the amount reported as a derivative asset on its balance sheet to the extent that amount exceeds collateral obtained from the counterparty or, if in a net liability position, the extent to which collateral posted exceeds the liability to the counterparty. The amounts reported as a derivative asset/(liability) are derivative contracts in a gain/(loss) position, and to the extent subject to master netting arrangements, net of derivatives in a loss/(gain) position with the same counterparty and collateral received/(pledged). If the counterparty fails to perform on a repurchase agreement, the Company is exposed to a loss to the extent that the fair value of collateral pledged exceeds the liability to the counterparty. The Company attempts to minimize counterparty credit risk by evaluating and monitoring the counterparty's credit, executing master netting arrangements and obtaining collateral, and executing contracts and agreements with multiple counterparties to reduce exposure to a single counterparty, where appropriate.

Our repurchase agreements and derivative transactions are governed by underlying agreements that provide for a right of setoff under master netting arrangements, including in the event of default or in the event of bankruptcy of either party to the transactions. We present our assets and liabilities subject to such arrangements on a net basis in our consolidated statements of financial condition. The following table presents information about our liabilities that are subject to such arrangements and can potentially be offset on our consolidated statements of financial condition as of September 30, 2014 and December 31, 2013. The Company has no financial instruments subject to master netting arrangements, or similar arrangements, in an asset position on a gross basis.



Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

September 30, 2014  
(dollars in thousands)

	Gross Amounts Not Offset with Financial Assets (Liabilities) in the Consolidated Statements of Financial Position					
	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Consolidated Statements of Financial Position	Net Amounts Offset in the Consolidated Statements of Financial Position	Financial Instruments	Cash Collateral (Received) Pledged (1)	Net Amount
Repurchase agreements	\$ (7,838,163)	\$ -	\$ (7,838,163)	\$ 8,524,273	\$ -	\$ 686,110
Interest Rate Swaps	(38,012 )	21,790	(16,222 )	29,220	78,725	91,723
Mortgage Options	-	-	-	-	-	-
Treasury Futures	7,800	-	7,800	-	8,855	16,655
Total Liabilities	\$ (7,868,375)	\$ 21,790	\$ (7,846,585)	\$ 8,553,493	\$ 87,580	\$ 794,488

(1) Included in other assets

(dollars in thousands)

	Gross Amounts Not Offset with Financial Assets (Liabilities) in the Consolidated Statements of Financial Position					
	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Consolidated Statements of Financial Position	Net Amounts Offset in the Consolidated Statements of Financial Position	Financial Instruments	Cash Collateral (Received) Pledged (1)	Net Amount
Repurchase agreements	\$ (1,658,561)	\$ -	\$ (1,658,561)	\$ 1,737,381	\$ -	\$ 78,820
Interest Rate Swaps	(30,199 )	-	(30,199 )	39,470	-	9,271
	-	-	-	-	-	-

Mortgage						
Options						
Treasury						
Futures	10,629	(2,534 )	8,095	-	-	8,095
Total						
Liabilities	\$ (1,678,131)	\$ (2,534 )	\$ (1,680,665)	\$ 1,776,851	\$ -	\$ 96,186

## 15. Management Agreement and Related Party Transactions

### Management Agreement

The Company entered into a management agreement with FIDAC, which provided for an initial term through December 31, 2010 with an automatic one-year extension option and subject to certain termination rights. Effective November 28, 2012, the management fee was reduced from 1.50% to 0.75% per annum of gross stockholders' equity, which remained in effect until the Company was current on all of its filings required under applicable securities laws. On August 8, 2014, the management agreement was amended and restated. Effective August 8, 2014, the management fee was increased to 1.20% of gross stockholders' equity. In addition, FIDAC agreed to pay the Company a one-time payment of approximately \$24 million to resolve issues raised in derivative demand letters sent to Chimera's Board of Directors. This amount equals a base management fee equal to 0.75% per annum of gross stockholders' equity as if it were in effect from January 1, 2012 through November 27, 2012. This payment was received by the Company during the third quarter of 2014 and is included in Other income in the Consolidated Statement of Operations.

The agreement provides for a two year term ending August 7, 2016 and may be automatically renewed for two year terms at each anniversary date unless at least two-thirds of the independent directors or the holders of a majority of the outstanding shares of common stock elects not to renew the agreement in their sole discretion and for any or no reason. Unless the management agreement is terminated for "cause" or FIDAC terminates the management agreement, in the event that the management agreement is terminated or not renewed, the Company must pay to FIDAC a termination fee equal to two times the average annual management fee, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination. FIDAC will continue to provide services under the management agreement for a period not less than 180 days from the date the Company delivers the notice not to renew the management agreement.

The Company may also terminate the management agreement with 30 days' prior notice from the Company's board of directors, without payment of a termination fee, for cause or upon a change of control of Annaly or FIDAC, each as defined in the management agreement. FIDAC may terminate the management agreement if the Company becomes required to register as an investment company under the Investment Company Act of 1940, as amended, with such termination deemed to occur immediately before such event, in which case the Company would not be required to pay a termination fee. FIDAC may also decline to renew the management agreement by providing the Company with 180-days' written notice, in which case the Company would not be required to pay a termination fee.

The management agreement provides that FIDAC will pay all past and future expenses that the Company and/or the Audit Committee of the Company incur to: (1) evaluate the Company's accounting policy related to the application of GAAP to its Non-Agency RMBS portfolio (the "Evaluation"); (2) restate the Company's financial statements for the period covering 2008 through 2011 as a result of the Evaluation (the "Restatement Filing"); and (3) investigate and evaluate any shareholder derivative demands arising from the Evaluation and/or the Restatement Filing (the "Investigation"); provided, however, that FIDAC's obligation to pay expenses applies only to expenses not paid by the Company's insurers under its insurance policies. Expenses shall include, without limitation, fees and costs incurred with respect to auditors, outside counsel, and consultants engaged by the Company and/or the Audit Committee of the Company for the Evaluation, Restatement Filing and the Investigation. The amount paid by FIDAC related to these expenses for the quarters ended September 30, 2014 and 2013 is \$2 million and \$3 million, respectively, and is presented in the Consolidated Statements of Operations and Comprehensive Income (Loss) as Expense recoveries from Manager. The amount paid by FIDAC related to these expenses for each of the nine months ended September 30, 2014 and 2013 is \$5 million, respectively.

The Company is obligated to reimburse FIDAC for costs incurred on the Company's behalf under the management agreement. In addition, the management agreement permits FIDAC to require the Company to pay for its pro rata portion of rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses that FIDAC incurred in connection with the Company's operations. These expenses are allocated between FIDAC and the Company based on the ratio of the Company's proportion of gross assets compared to the gross assets managed by FIDAC as calculated at each quarter end. FIDAC and the Company will modify this allocation methodology, subject to the approval of the Company's board of directors if the allocation becomes inequitable (i.e., if the Company becomes very highly leveraged compared to FIDAC's other funds and accounts). During the quarters and nine months ended September 30, 2014 and 2013, reimbursements to FIDAC were not significant.

The Company paid management fees of \$9 million and \$7 million for each of the quarters ended September 30, 2014 and 2013, respectively. The Company paid management fees of \$22 million and \$20 million for each of the nine months ended September 30, 2014 and 2013, respectively. We also paid our Manager reimbursements of \$2 million and \$1 million for the quarters ended September 30, 2014 and 2013 and \$5 million for each of the nine months ended September 30, 2014 and 2013, respectively. None of the reimbursement payments is attributable to the compensation of our named executive officers.

#### RCap

On March 1, 2011, the Company entered into an administrative services agreement with RCap Securities Inc., ("RCap"). RCap is a SEC-registered broker-dealer and a wholly-owned subsidiary of Annaly that clears the Company's securities trades in return for normal and customary fees that RCap charges for such services. RCap may also provide brokerage services to the Company from time to time. During the quarters and nine months ended September 30, 2014 and 2013, fees paid to RCap were less than \$1 million.

#### 16. Commitments and Contingencies

From time to time, the Company may become involved in various claims and legal actions arising in the ordinary course of business. In connection with certain re-securitization transactions engaged in by the Company, the Company has the obligation under certain circumstances to repurchase assets from the VIE upon breach of certain representations and warranties. Management is not aware of any contingencies that require accrual or disclosure as of September 30, 2014 and December 31, 2013.

17. Subsequent Events

The Board of Directors has determined that there will be a quarterly dividend of \$0.09 per share for the fourth quarter of 2014.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of the Company's ("we" or "our") financial condition and results of operations should be read in conjunction with the consolidated financial statements and notes to those statements included in Item 1 of this quarterly report on Form 10-Q.

### SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

- our business and investment strategy;
- our ability to maintain existing financing arrangements and our ability to obtain future financing arrangements;
- our ability to timely file our periodic reports with the Securities and Exchange Commission, or SEC;
- our expectations regarding materiality or significance;
- the effectiveness of our disclosure controls and procedures;
- material weaknesses in our internal controls over financial reporting;
- additional information that may arise from the preparation of our financial statements;
- inadequacy of or weakness in our internal controls over financial reporting of which we are not currently aware or which have not been detected;
- general volatility of the securities markets in which we invest;
- the impact of and changes to various government programs;
- our expected investments;
- changes in the value of our investments;
- interest rate mismatches between our investments and our borrowings used to finance such purchases;

changes in interest rates and mortgage prepayment rates;

effects of interest rate caps on our adjustable-rate investments;

rates of default, delinquencies or decreased recovery rates on our investments;

prepayments of the mortgage and other loans underlying our mortgage-backed securities, or RMBS, or other asset-backed securities, or ABS;

the degree to which our hedging strategies may or may not protect us from interest rate volatility;

impact of and changes in governmental regulations, tax law and rates, accounting guidance, and similar matters;

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

availability of qualified personnel;

estimates relating to our ability to make distributions to our stockholders in the future;

our understanding of our competition;

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

our ability to maintain our classification as a real estate investment trust, or REIT, for federal income tax purposes; and

our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended, or 1940 Act.

The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. You should not place undue reliance on these forward-looking statements. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us. Some of these factors are described under the caption ‘‘Risk Factors’’ in our 2013 Form 10-K. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made. New risks and uncertainties arise from time to time, and it is impossible for us to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## Executive Summary

We are a Maryland corporation that commenced operations on November 21, 2007. We acquire, either directly or indirectly through our subsidiaries, residential mortgage-backed securities, or RMBS, residential mortgage loans, commercial mortgage loans, real estate related securities and various other asset classes. We are externally managed by Fixed Income Discount Advisory Company, which we refer to as FIDAC or our Manager. FIDAC is a fixed-income investment management company that is registered as an investment adviser with the SEC. FIDAC is a wholly owned subsidiary of Annaly Capital Management, Inc., or Annaly. FIDAC has a broad range of experience in managing investments in Agency RMBS, which are mortgage pass-through certificates, collateralized mortgage obligations, or CMOs, and other RMBS representing interests in or obligations backed by pools of mortgage loans issued or guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae, Non-Agency RMBS, collateralized debt obligations, or CDOs, and other real estate related investments.

Our objective is to provide attractive risk-adjusted returns to our investors over the long-term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by investing in a diversified investment portfolio of RMBS, residential mortgage loans, real estate-related securities and various other asset classes, subject to maintaining our REIT status and exemption from registration under the 1940 Act. The RMBS, ABS, CMBS, and CDOs we purchase may include investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes.

We rely on our Manager's expertise in identifying assets within our target asset classes. Our Manager makes investment decisions based on various factors, including expected cash yield, relative value, risk-adjusted returns, current and projected credit fundamentals, current and projected macroeconomic considerations, current and projected supply and demand, credit and market risk concentration limits, liquidity, cost of financing and financing availability, as well as maintaining our REIT qualification and our exemption from registration under the 1940 Act.

Over time, we will modify our investment allocation strategy as market conditions change to seek to maximize the returns from our investment portfolio. We believe this strategy, combined with our Manager's experience, will enable us to pay dividends and achieve capital appreciation through various changing interest rate and credit cycles and provide attractive long-term returns to investors.

Our targeted asset classes and the principal investments we have made and in which we may in the future invest are:

Asset Class	Principal Investments
RMBS	<p>Non-Agency RMBS, including investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes</p> <p>Agency RMBS</p> <p>Interest-only ("IO") RMBS</p>
Residential Mortgage Loans	<p>Prime mortgage loans, which are mortgage loans that conform to the underwriting guidelines of Fannie Mae and Freddie Mac, which we refer to as Agency Guidelines; and jumbo prime mortgage loans, which are mortgage loans that conform to the Agency Guidelines except as to loan size</p>

Alt-A mortgage loans, which are mortgage loans that may have been originated using documentation standards that are less stringent than the documentation standards applied by certain other first lien mortgage loan purchase programs, such as the Agency Guidelines, but have one or more compensating factors such as a borrower with a strong credit or mortgage history or significant assets



Seasoned sub-prime mortgage loans, which are mortgage loans that may have been originated using documentation standards that are less stringent than prime mortgage loans and that have borrowers who have credit or mortgage history which would not meet the standards for prime mortgage loans or Alt-A mortgage loans.

FHA/VA insured loans, which are mortgage loans that comply with the underwriting guidelines of the Federal Housing Administration (FHA) or Department of Veteran Affairs (VA) and which are guaranteed by the FHA or VA, respectively

Mortgage servicing rights associated with residential mortgage loans, which reflect the value of the future stream of expected cash flows from the contractual rights to service a given pool of residential mortgage loans

Commercial Mortgage Loans First or second lien loans secured by multifamily properties, which are residential rental properties consisting of five or more dwelling units; and mixed residential or other commercial properties; retail properties; office properties; or industrial properties, which may or may not conform to the Agency Guidelines

Other Asset-Backed Securities CMBS

Debt and equity tranches of CDOs

Consumer and non-consumer ABS, including investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes

Hedging Instruments Swaps

Swaptions

Futures

Index options

Mortgage options

Since we commenced operations in November 2007, we have focused our investment activities on acquiring Non-Agency and Agency RMBS and on purchasing residential mortgage loans that have been originated by select originators, including the retail lending operations of leading commercial banks. At September 30, 2014, based on the amortized cost balance of our interest earning assets, approximately 50% of our investment portfolio was Agency RMBS, 16% of our investment portfolio was Non-Agency RMBS, and 34% of our investment portfolio was securitized residential mortgage loans. At December 31, 2013, based on the amortized cost balance of our interest earning assets, approximately 36% of our investment portfolio was Agency RMBS, 50% of our investment portfolio was Non-Agency RMBS, and 14% of our investment portfolio was securitized residential mortgage loans. During the third quarter of 2014, we increased our securitized loans held for investment by \$4.8 billion, primarily financed with securitized debt collateralized by the loans acquired during the quarter.

We have engaged in transactions with residential mortgage lending operations of leading commercial banks and other originators in which we identified and re-underwrote residential mortgage loans owned by such entities, and purchased and securitized such residential mortgage loans. In the past we have also acquired formerly AAA-rated Non-Agency RMBS and immediately re-securitized those securities. We sold the resulting AAA-rated super senior RMBS and retained the rated or unrated mezzanine RMBS.

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

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

We have elected and believe we are organized and have operated in a manner that qualifies us to be taxed as a REIT under the Code. A REIT generally will not be subject to federal income tax on taxable income that is distributed to stockholders. Furthermore, substantially all of our assets consist of qualified REIT real estate assets (of the type described in Code Section 856(c)(5)). We calculate that at least 75% of our assets were qualified REIT assets, as defined in the Code, for the quarters ended September 30, 2014 and the years ended December 31, 2013 and 2012. We also calculate that our revenues qualified for the 75% REIT income test and for the 95% REIT income test for the quarter and nine months ended September 30, 2014 and for the years ended December 31, 2013 and 2012. We also met all REIT requirements regarding the ownership of our common stock and the distribution of our REIT taxable income. Therefore, for the quarter and nine months ended September 30, 2014 and for the years ended December 31, 2013 and 2012, we believe that we qualified as a REIT under the Code.

We operate our business to be exempt from registration under the 1940 Act, and therefore we are required to invest a substantial majority of our assets in loans secured by mortgages on real estate and real estate-related assets. Subject to maintaining our REIT qualification and our 1940 Act exemption, we do not have any limitations on the amounts we may invest in any of our targeted asset classes.

Looking forward, we cannot predict the percentage of our assets that will be invested in each asset class or whether we will invest in other classes of investments. We may change our investment strategy and policies without a vote of our stockholders.

#### Net Income Summary

The table below presents our net income on a GAAP basis for the quarters and nine months ended September 30, 2014 and 2013.

Net Income (Loss)  
(dollars in thousands)  
(unaudited)

	For the Quarter Ended		For the Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Net Interest Income:				
Interest income	\$86,613	\$38,818	\$171,125	\$101,514
Interest expense	(9,902 )	(1,580 )	(15,132 )	(5,042 )
Interest income, Assets of consolidated VIEs	103,742	91,543	274,215	282,207
Interest expense, Non-recourse liabilities of consolidated VIEs	(28,984 )	(23,494 )	(66,859 )	(75,472 )
Net interest income (expense)	151,469	105,287	363,349	303,207
Other-than-temporary impairments:				
Total other-than-temporary impairment losses	(726 )	(2,209 )	(4,939 )	(2,209 )
Portion of loss recognized in other comprehensive income (loss)	(1,264 )	(14,246 )	(3,932 )	(20,409 )
Net other-than-temporary credit impairment losses	(1,990 )	(16,455 )	(8,871 )	(22,618 )
Other gains (losses):				
Net unrealized gains (losses) on derivatives	12,975	27	(11,720 )	18,607
Net realized gains (losses) on derivatives	(23,152 )	(3,391 )	(48,692 )	(14,312 )
Realized gains (losses) on terminations of interest rate swaps	-	-	-	-
Net gains (losses) on derivatives	(10,177 )	(3,364 )	(60,412 )	4,295
Net unrealized gains (losses) on financial instruments at fair value	162,921	(27,874 )	183,722	(41,861 )
Net realized gains (losses) on sales of investments	64,107	18,816	68,145	72,939
Gain on deconsolidation	-	-	47,846	-
Realized losses on principal write-downs of Non-Agency RMBS	-	-	(2,184 )	-
Total other gains (losses)	216,851	(12,422 )	237,117	35,373
Net investment income (loss)	366,330	76,410	591,595	315,962
Other (income) and expenses:				
Management fees	9,381	6,570	21,873	19,517
Expense recoveries from Manager	(1,975 )	(1,082 )	(4,820 )	(6,252 )
Net management fees	7,406	5,488	17,053	13,265
General and administrative expenses	5,772	3,624	15,718	13,668
(Income)/expense for change in loan loss provision	(645 )	(69 )	(112 )	(1,348 )
Other (income) expense	(23,783 )	-	(23,783 )	-
Total other expenses	(11,250 )	9,043	8,876	25,585
Income (loss) before income taxes	377,580	67,367	582,719	290,377
Income taxes	-	-	2	2
Net income (loss)	\$377,580	\$67,367	\$582,717	\$290,375

Our net income increased by \$310 million to \$378 million, or \$0.37 per average basic common share, for the quarter ended September 30, 2014 as compared to \$67 million, or \$0.07 per average basic common share, for the quarter ended September 30, 2013. The increase in earnings for the quarter ended September 30, 2014 over the same period of 2013 is primarily attributable to the change in unrealized gain on financial instruments at fair value, which is recognized in earnings, of \$191 million. The unrealized gain on financial instruments at fair value is primarily driven by a \$139 million gain on the loans held for investment acquired in the third quarter for which we elected the fair value option with changes in fair value recognized in earnings. This gain is unrealized and may not ultimately be realized and does not affect our ability to pay dividends.

During the third quarter of 2014, we increased our interest income, net of interest expense, by \$46 million to \$151 million as compared to \$105 million in the same period of 2013. During the third quarter of 2014, we recognized net realized gains on sales of investments of \$64 million, an increase of \$45 million over the same period in 2013. During the third quarter, we also received a one time \$24 million payment from our manager during the quarter.

Our net income increased by \$292 million to \$583 million, or \$0.57 per average basic common share, for the nine months ended September 30, 2014 as compared to \$290 million, or \$0.28 per average basic common share, for the nine months ended September 30, 2013. The increase in earnings for the nine months ended September 30, 2014 over the same period of 2013 is again primarily attributable to the change in unrealized gain on financial instruments at fair value, which is recognized in earnings, of \$226 million.

During the first nine months of 2014, we increased our interest income, net of interest expense, by \$60 million to \$363 million for the first nine months of 2014 as compared to \$303 million in the same period of 2013. The Company has added positions to both its Agency and loans held for investment portfolios during 2014 which we expect to have a positive impact on net interest income over the next few quarters.

We discuss the changes in our net income in greater detail in the discussion on our results of operations below.

## Trends

We expect the results of our operations to be affected by various factors, many of which are beyond our control. Our results of operations will primarily depend on, among other things, the level of our net interest income, the market value of our assets, and the supply of and demand for such assets. Economic trends, both macro as well as those directly affecting the residential housing market, and the supply and demand of RMBS may affect our operations and financial results. We also evaluate market information regarding current residential mortgage loan underwriting criteria and loan defaults to manage our portfolio of assets, leverage, and debt. Our net interest income, which reflects the amortization of purchase premiums and accretion of discounts, varies primarily as a result of changes in interest rates, borrowing costs, credit impairment losses, and prepayment speeds, which is a measurement of how quickly borrowers pay down the unpaid principal balance on their mortgage loans. Further description of these factors is provided below.

**Prepayment Speeds.** Prepayment speeds, as reflected by the Constant Prepayment Rate, or CPR, vary according to interest rates, the type of investment, conditions in financial markets, and other factors, none of which can be predicted with any certainty. In general, when interest rates rise, it is relatively less attractive for borrowers to refinance their mortgage loans, and as a result, prepayment speeds tend to decrease. When interest rates fall, prepayment speeds tend to increase. For mortgage loan and RMBS investments purchased at a premium, as prepayment speeds increase, the amount of income we earn decreases as the purchase premium on the bonds amortizes faster than expected. Conversely, decreases in prepayment speeds result in increased income and can extend the period over which we amortize the purchase premium. For mortgage loan and RMBS investments purchased at a discount, as prepayment speeds increase, the amount of income we earn increases from the acceleration of the accretion of the discount into interest income. Conversely, decreases in prepayment speeds result in decreased income as the accretion of the purchase discount into interest income occurs over a longer period. Recently, the correlation between interest rates and prepayment has not followed normal trends for certain asset classes. Due to economic hardship, some borrowers have been unable to refinance their loans as underwriting standards are more stringent and credit conditions remain restrictive.

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

**Falling Interest Rate Environment.** As indicated above, as interest rates rise, prepayment speeds generally decrease. Rising interest rates, however, increase our financing costs which may result in a net negative impact on our net interest income. The company attempts to mitigate some of the risk of rising interest rates by using interest rate derivative hedges such as swaps, futures and options that are designed to increase in value if interest rates rise. When interest rates fall, the value of such interest rate derivatives also fall in value as the risk the derivative is designed to hedge is lower. We expect our interest rate hedges to lose value in a falling interest rate environment and reduce net income.

**Credit Risk.** One of our strategic focuses is on acquiring distressed Non-Agency RMBS that have been downgraded because of defaults in the mortgages collateralizing such RMBS. When we acquire such RMBS we attempt to purchase it at a price such that its loss-adjusted return profile is in line with our targeted yields. We retain the risk of potential credit losses on all of the residential mortgage loans we hold in our portfolio as well as all of the

**Non-Agency RMBS.** We attempt to mitigate credit risk in the asset selection process. Prior to the purchase of investments, we conduct a credit-risk based analysis of the collateral securing our investment that includes examining borrower characteristics, geographic concentrations, current and projected delinquencies, current and projected severities, and actual and expected prepayment speeds among other characteristics to estimate expected losses. We also acquire assets which we believe to be of high credit quality.

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

## Financial Condition

### Estimated Economic Book Value

This Management Discussion and Analysis section contains analysis and discussion of financial information that utilizes or presents ratios based on GAAP book value. The table and discussion below present our estimated economic book value. We calculate and disclose this non-GAAP measurement because we believe it represents an estimate of the fair value of the assets we own or are able to dispose of, pledge, or otherwise monetize. The estimated economic book value should not be viewed in isolation and is not a substitute for book value computed in accordance with GAAP.

GAAP requires us to consolidate certain securitizations and re-securitization transactions where we have determined that we are the primary beneficiary. In these transactions, we transferred assets to the trusts, which issued tranches of senior and subordinate notes or certificates. We sold the senior tranches and therefore have no continuing involvement in these trusts other than being a holder of notes or certificates issued by the trusts, with the same rights as other holders of the notes or certificates, except as it relates to certain VIEs collateralized by loans held for investment. As it relates solely to certain VIEs collateralized by loans held for investment, we have the ability to approve loan modifications and determine the course of action to be taken as it relates to loans in technical default, including whether or not to proceed with foreclosure. The notes and certificates we own that were issued by the trusts are largely subordinated interests in those trusts. The trusts have no recourse to our assets other than pursuant to a breach by us of the transaction documents related to the transfer of the assets by us to the trusts, but are presented as if we own 100% of the trust.

For re-securitized RMBS transactions and loan securitizations, we present the pre-securitized assets transferred into the consolidated trusts in our Consolidated Statements of Financial Condition as Non-Agency RMBS transferred to consolidated variable interest entities or Securitized loans held for investment. Post securitization RMBS assets sold are presented as liabilities in our Consolidated Statements of Financial Condition as Securitized debt, collateralized by Non-Agency RMBS and Securitized debt, collateralized by loans held for investment. We have presented the underlying securities we transferred to the trusts for the calculation of GAAP book value at fair value and recorded the corresponding liability for the notes or certificates sold to third parties at amortized cost. Fair value adjustments that are not credit related are recorded in Other comprehensive income (loss). Credit related impairments are deemed other-than-temporary and are recorded in earnings.

Because we are unable to dispose of, monetize or pledge the RMBS or loans we transferred into the trusts, we also present our estimated economic book value. We believe this measure represents the estimated value of the securities issued by these trusts that we own. In contrast to GAAP book value, our estimated economic book value considers only the assets we own or are able to dispose of, pledge, or otherwise monetize. To determine our estimated economic book value, we consider only the fair value of the notes or certificates issued by the securitization and re-securitization trusts that we actually own. Accordingly, our estimated economic book value does not include assets or liabilities for which we have no direct ownership, specifically the notes or certificates of the securitization and re-securitization trusts that were sold to third parties.

At September 30, 2014, the difference between GAAP book value and estimated economic book value was determined to be \$359 million, or \$0.35 per share. At December 31, 2013, the difference between GAAP book value and estimated economic book value was determined to be \$438 million, or \$0.42 per share. This difference is primarily driven by the value of the RMBS assets we have retained in these re-securitization transactions as compared to the value of consolidated loans and securities net of RMBS assets sold, but treated as a secured financing and recorded at amortized cost on the statement of financial condition. In these re-securitization transactions, we have generally retained the subordinated, typically non-rated, first loss notes or certificates issued by the securitization



trusts. These securities are complex, typically locked out as to principal repayment, relatively illiquid, and do not necessarily appreciate or depreciate in tandem with the broader Non-Agency RMBS market or with the loans on securities owned by the trusts. As the senior notes pay off, we expect the difference between our economic and our GAAP book value to decrease. The tables below present the adjustments to GAAP book value that we believe are necessary to adequately reflect our calculation of estimated economic book value as of September 30, 2014 and December 31, 2013.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

September 30, 2014  
(dollars in thousands, except per share data)

	GAAP Book Value	Adjustments	Estimated Economic Book Value
<b>Assets:</b>			
<b>Non-Agency RMBS, at fair value</b>			
Senior	\$ 239,934	\$ 218,717	\$ 458,651
Senior interest-only	207,840	70,707	278,547
Subordinated	439,967	1,970,558	2,410,525
Subordinated interest-only	7,340	3,610	10,950
RMBS transferred to consolidated VIEs	2,528,335	(2,528,335 )	-
<b>Agency RMBS, at fair value</b>			
Pass-through	7,955,805	-	7,955,805
Interest-only	114,169	-	114,169
Securitized loans held for investment, net of allowance for loan losses	678,866	(678,866 )	-
Securitized loans held for investment, at fair value	4,816,551	(4,816,551 )	-
Other assets	502,163	-	502,163
<b>Total assets</b>	<b>\$ 17,490,970</b>	<b>\$ (5,760,160 )</b>	<b>\$ 11,730,810</b>
<b>Liabilities:</b>			
Repurchase agreements	7,838,163	-	7,838,163
Securitized debt, collateralized by Non-Agency RMBS	742,894	(742,894 )	-
Securitized debt, collateralized by loans held for investment	572,742	(572,742 )	-
Securitized debt at fair value, collateralized by loans held for investment	3,737,602	(3,737,602 )	-
Other liabilities (1)	1,008,342	(347,800 )	660,542
<b>Total liabilities</b>	<b>13,899,743</b>	<b>(5,401,038 )</b>	<b>8,498,705</b>
<b>Total stockholders' equity</b>	<b>3,591,227</b>	<b>(359,122 )</b>	<b>3,232,105</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 17,490,970</b>	<b>\$ (5,760,160 )</b>	<b>\$ 11,730,810</b>
<b>Book Value Per Share</b>	<b>\$ 3.50</b>	<b>\$ (0.35 )</b>	<b>\$ 3.15</b>

(1) Primarily payable for investments purchased.

December 31, 2013  
(dollars in thousands, except per share data)

GAAP Book Adjustments

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

	Value		Estimated Economic Book Value
<b>Assets:</b>			
Non-Agency RMBS, at fair value			
Senior	\$ 89,687	\$ 12,365	\$ 102,052
Senior interest-only	229,065	116,951	346,016
Subordinated	457,569	1,593,924	2,051,493
Subordinated interest-only	16,571	280	16,851
RMBS transferred to consolidated VIEs			
	2,981,571	(2,981,571 )	-
Agency RMBS, at fair value			
Pass-through	1,954,796	-	1,954,796
Interest-only	42,782	-	42,782
Securitized loans held for investment, net of allowance for loan losses	783,484	(783,484 )	-
Other assets	380,556	-	380,556
<b>Total assets</b>	<b>\$ 6,936,081</b>	<b>\$ (2,041,535 )</b>	<b>\$ 4,894,546</b>
<b>Liabilities:</b>			
Repurchase agreements, RMBS	1,658,561	-	1,658,561
Securitized debt, collateralized by Non-Agency RMBS	933,732	(933,732 )	-
Securitized debt, collateralized by loans held for investment	669,981	(669,981 )	-
Other liabilities	342,297	-	342,297
<b>Total liabilities</b>	<b>3,604,571</b>	<b>(1,603,713 )</b>	<b>2,000,858</b>
<b>Total stockholders' equity</b>	<b>3,331,510</b>	<b>(437,822 )</b>	<b>2,893,688</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 6,936,081</b>	<b>\$ (2,041,535 )</b>	<b>\$ 4,894,546</b>
<b>Book Value Per Share</b>	<b>\$ 3.24</b>	<b>\$ (0.42 )</b>	<b>\$ 2.82</b>

Our estimate of economic book value has important limitations. Our estimate of fair value is as of a point in time and subject to significant judgment, primarily the estimate of the fair value of the securities issued by the trusts which we own and can freely sell or pledge. Should we sell the assets in our portfolio, we may realize materially different proceeds from the sale than we have estimated as of the reporting date.

The calculation of estimated economic book value described above is used by management to understand the fair value of the assets we own and the liabilities for which we are legally obligated, and is presented for informational use only. The estimated economic book value should not be viewed in isolation and is not a substitute for book value computed in accordance with GAAP.

#### Portfolio Review

During the nine months ended September 30, 2014, on an aggregate basis, we purchased \$8.2 billion, sold \$1.9 billion, and received \$654 million in principal payments related to our Agency RMBS, Non-Agency RMBS, and loans held for investment. In addition, we used \$564 million of proceeds from our assets to repay principal on our securitized debt during this same period. The \$8.2 billion of purchases includes \$774 million used to acquire our interests in the pools of seasoned sub-prime residential mortgage loans during the third quarter of 2014.

The following table summarizes certain characteristics of our portfolio at September 30, 2014 and December 31, 2013.

	September 30, 2014		December 31, 2013	
Interest earning assets at period-end (1)	\$ 16,988,807		\$ 6,555,525	
Interest bearing liabilities at period-end	\$ 12,891,401		\$ 3,262,274	
Leverage at period-end	3.8:1		1.0:1	
Leverage at period-end (recourse)	2.6:1		0.5:1	
Portfolio Composition, at amortized cost				
Non-Agency RMBS	15.9	%	49.8	%
Senior	1.3	%	1.5	%
Senior, interest only	1.5	%	5.1	%
Subordinated	2.1	%	6.0	%
Subordinated, interest only	0.1	%	0.3	%
RMBS transferred to consolidated VIEs				
Agency RMBS	10.9	%	36.9	%
Pass-through	0.0	%	36.1	%
Interest-only	49.7	%	35.3	%
Securitized loans	0.7	%	0.8	%
Fixed-rate percentage of portfolio	33.7	%	14.1	%
Adjustable-rate percentage of portfolio	92.3	%	76.3	%
	7.7	%	23.7	%

(1) Excludes cash and cash equivalents.

The following table presents details of each asset class in our portfolio at September 30, 2014 and December 31, 2013. The principal or notional value represents the interest income earning balance of each class. The weighted average figures are weighted by each investment's respective principal/notional value in the asset class.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

September 30, 2014

	Principal or Notional Value at Period-End (dollars in thousands)	Weighted Average Amortized Cost Basis	Weighted Average Fair Value	Weighted Average Coupon	Weighted Average Yield at Period-End (1)	Weighted Average CPR at Period-End	Weighted Average CPR at Period-End	Weighted Average Delinquency at Pipeline 60+	Weighted Average Loss Severity at Enhancement (2)	Weighted Average Credit at Period-End	Principal Writedowns During Period (dollars in thousands)
<b>Non-Agency Mortgage-Backed Securities</b>											
Senior	\$312,619	\$68.46	\$76.76	2.4%	5.5 %	11.2%	11.4%	31.6%	66.7%	9.7 %	\$1,118
Senior, interest only	\$5,383,454	\$4.44	\$3.86	1.6%	15.2%	13.7%	13.8%	21.1%	50.7%	0.0 %	\$-
Subordinated	\$689,332	\$48.81	\$63.83	3.3%	10.5%	15.5%	15.9%	15.9%	46.0%	11.7%	\$6,043
Subordinated, interest only	\$218,527	\$4.51	\$3.36	0.9%	8.4 %	13.0%	13.8%	14.4%	45.6%	0.0 %	\$-
RMBS transferred to consolidated VIEs	\$3,226,298	\$54.62	\$79.46	4.6%	17.1%	11.8%	11.1%	23.4%	58.4%	1.3 %	\$27,232
<b>Agency Mortgage-Backed Securities</b>											
Pass-through	\$7,553,614	\$104.96	\$105.32	4.0%	3.1 %	6.0 %	9.0 %	NA	NA	0.0 %	\$-
Interest-only	\$2,016,717	\$5.81	\$5.66	1.1%	3.7 %	9.1 %	9.1 %	NA	NA	0.0 %	\$-
Securitized loans	\$5,421,978	\$99.04	\$101.35	6.6%	49.8%	7.1 %	6.6 %	5.0 %	50.6%	36.5%	\$570

(1) Bond Equivalent Yield at period end. Weighted Average Yield is calculated using each investment's respective amortized cost.

(2) Calculated based on reported losses to date, utilizing widest data set available (i.e., life-time losses, 12-month loss, etc.)

December 31, 2013

	Principal or Notional Value at Period-End (dollars in thousands)	Weighted Average Amortized Cost Basis	Weighted Average Fair Value	Weighted Average Coupon	Weighted Average Yield at Period-End (1)	Weighted Average CPR at Period-End	Weighted Average CPR at Period-End	Weighted Average Delinquency at Pipeline 60+	Weighted Average Loss Severity at Enhancement (2)	Weighted Average Credit at Period-End	Principal Writedowns During Period (dollars in thousands)
<b>Non-Agency Mortgage-Backed Securities</b>											
Senior	\$128,217	\$69.27	\$69.95	1.4%	5.9 %	12.1%	15.1%	38.0%	63.3%	8.3 %	\$297
Senior, interest only	\$5,742,781	\$4.93	\$3.99	1.4%	17.2%	15.2%	16.8%	19.9%	51.1%	0.0 %	\$-
Subordinated	\$830,632	\$40.96	\$55.09	2.9%	13.5%	17.0%	19.6%	16.2%	49.6%	12.6%	\$6,563
Subordinated, interest only	\$274,462	\$5.34	\$6.04	1.7%	9.0 %	17.0%	18.1%	15.4%	45.0%	0.0 %	\$-
RMBS transferred to consolidated VIEs	\$3,912,376	\$54.17	\$77.82	4.7%	15.8%	11.7%	14.7%	25.8%	57.9%	1.6 %	\$34,386

Agency  
Mortgage-Backed  
Securities

Pass-through	\$ 1,898,131	\$ 104.52	\$ 105.24	3.6%	3.3 %	7.7 %	18.2%	NA	NA	0.0 %	\$-
Interest-only	\$ 247,344	\$ 17.69	\$ 17.30	3.2%	5.3 %	9.8 %	17.5%	NA	NA	0.0 %	\$-
Securitized loans	\$ 776,074	\$ 102.12	\$ 98.26	4.7%	3.5 %	18.3%	36.4%	1.5 %	22.3%	16.4%	\$(6 )

(1) Bond Equivalent Yield at period end. Weighted Average Yield is calculated using each investment's respective amortized cost.

(2) Calculated based on reported losses to date, utilizing widest data set available (i.e., life-time losses, 12-month loss, etc.)

Based on the projected cash flows for our Non-Agency RMBS that are not of high credit quality, a portion of the original purchase discount is designated as Accretable Discount, which reflects the purchase discount expected to be accreted into interest income, and a portion is designated as Non-Accretable Difference, which represents the contractual principal on the security that is not expected to be collected. The amount designated as Non-Accretable Difference may be adjusted over time, based on the actual performance of the security, its underlying collateral, actual and projected cash flow from such collateral, economic conditions and other factors. If the performance of a security is more favorable than previously estimated, a portion of the amount designated as Non-Accretable Difference may be accreted into interest income over time. Conversely, if the performance of a security is less favorable than previously estimated, the amounts designated as Non-Accretable Difference may increase, resulting in an OTTI loss.

The following table presents changes to Accretable Discount and Non-Accretable Difference as it pertains to our entire Non-Agency RMBS portfolio for assets with purchase discounts during the previous five quarters.

	For the Quarter Ended				
	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013
	(dollars in thousands)				
	Accretable Discount				
Balance, beginning of period	\$ 951,305	\$ 990,202	\$ 996,694	\$ 1,012,513	\$ 1,026,921
Accretion of discount	(39,062 )	(42,101 )	(40,304 )	(40,812 )	(40,001 )
Purchases	126,753	(6,773 )	18,815	-	-
Sales and deconsolidation	(66,161 )	(669 )	(3,843 )	-	(6,655 )
Transfers from credit reserve	11,809	17,134	31,666	28,962	35,054
Transfers to credit reserve	(7,601 )	(6,488 )	(12,826 )	(3,969 )	(2,806 )
Balance, end of period	\$ 977,042	\$ 951,305	\$ 990,202	\$ 996,694	\$ 1,012,513

	For the Quarter Ended				
	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013
	(dollars in thousands)				
	Non-Accretable Difference				
Balance, beginning of period	\$ 1,046,519	\$ 1,171,130	\$ 1,217,793	\$ 1,261,945	\$ 1,370,792
Principal Writedowns	(81,289 )	(41,155 )	(47,079 )	(41,708 )	(93,054 )
Purchases	126,753	(6,773 )	18,815	-	-
Sales and deconsolidation	(156,096 )	(71,384 )	(1,093 )	-	-
Net other-than-temporary credit impairment losses	1,990	5,347	1,534	22,549	16,455

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Transfers from credit reserve	(11,809 )	(17,134 )	(31,666 )	(28,962 )	(35,054 )
Transfers to credit reserve	7,601	6,488	12,826	3,969	2,806
Balance, end of period	\$ 933,668	\$ 1,046,519	\$ 1,171,130	\$ 1,217,793	\$ 1,261,945

### Critical Accounting Policies and Estimates

We prepare our financial statements in accordance with accounting principles generally accepted in the United States, or GAAP, which requires the use of estimates and assumptions. Management has discussed and reviewed the development, selection, and disclosure of critical accounting estimates with the Company's Audit Committee. Management believes that the most critical accounting policies and estimates, since these estimates require significant judgment, are interest income and other-than-temporary impairment, or OTTI, on Non-Agency RMBS, the determination of the appropriate accounting model for Non-Agency RMBS, the impact of default and prepayment assumptions on RMBS, and fair value measurements. Financial results could be materially different if other methodologies were used or if management modified its assumptions.

For a discussion of the Company's critical accounting policies and estimates, see "Critical Accounting Policies and Estimates" in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

### Recent Accounting Pronouncements

Refer to Note 2(q) in the Notes to Consolidated Financial Statements for a discussion of accounting guidance recently adopted by the Company or expected to be adopted by the Company in the future.

### Results of Operations for the Quarters and Nine Months Ended September 30, 2014 and 2013

Our primary source of income is interest income earned on our assets and our primary expense is interest expense, including our periodic interest costs of interest rate derivatives.

#### Interest Income

Interest income increased by \$60 million to \$190 million for the quarter ended September 30, 2014 from \$130 million for the same period of 2013. The increase is primarily due to the increase in agency holdings of approximately \$6.0 billion acquired at the end of the second quarter and the increase in securitized loans of approximately \$4.8 billion acquired during the third quarter. Net interest income on our Agency RMBS portfolio increased by \$35 million and net interest income on our securitized loan portfolio increased by \$25 million. Both portfolios increased from the prior quarter due to significant purchases. The significant increase in these two groups of interest earning assets is expected to contribute to our interest income earned for future periods.

Interest income increased by \$62 million to \$445 million for the nine months ended September 30, 2014 from \$384 million for the same period of 2013. The increase is also primarily due to increased Agency RMBS and securitized loans during 2014 over the same period of the prior year.

#### Interest Expense

Interest expense increased by \$14 million to \$39 million for the quarter ended September 30, 2014 from \$25 million for the same period of 2013. The increase is primarily due to increased interest expense on our repurchase agreements and, to a lesser extent, the increase in our securitized debt. Our repurchase agreement obligation increased by \$6.2 billion to \$7.8 billion as of September 30, 2014 as compared to \$1.6 billion as of September 30, 2013. This increased borrowing was used to acquire both Agency and Non-Agency RMBS. Interest expense for GAAP reporting does not include the periodic costs of our derivatives, which are reported separately.



Interest expense increased by \$1 million to \$82 million for the nine months ended September 30, 2014 from \$81 million for the same period of 2013. An increase in interest expense of \$10 million on our repurchase agreements and \$6 million on our securitized debt collateralized by residential mortgage loans was largely offset by reduced financing costs of \$15 million on our securitized debt collateralized by Non-Agency RMBS as this financing has continued to pay down. The interest expense on the securitized debt consolidated with the securitized loans acquired in the third quarter did not significantly impact the year to date interest expense as this financing was acquired in the second half of the third quarter.

## Net Economic Interest Income

Our economic net interest income equals interest income excluding interest earned on cash and cash equivalents less interest expense and realized losses on our interest rate hedges. For the purpose of computing economic net interest income and ratios relating to cost of funds measures throughout this section, interest expense includes net payments on our interest rate swaps, which is presented as a part of Realized gains (losses) on derivatives in our Consolidated Statements of Operations and Comprehensive Income. Interest rate hedges are used to manage the increase in interest paid on repurchase agreements in a rising rate environment. Presenting the net contractual interest payments on interest rate hedges with the interest paid on interest-bearing liabilities reflects our total contractual interest payments. We believe this presentation is useful to investors because this presentation depicts the economic value of our investment strategy, by showing actual interest expense and net interest income. Where indicated, interest expense, including interest payments on interest rate hedges, is referred to as economic interest expense. Where indicated, net interest income reflecting interest payments on interest rate hedges, is referred to as economic net interest income.

The following table reconciles the GAAP and non-GAAP measurements reflected in the Management's Discussion and Analysis of Financial Condition and Results of Operations.

	GAAP Interest Income	GAAP Interest Expense	Add: Net Realized Losses on Interest Rate Hedges	Economic Interest Expense	GAAP Net Interest Income	Less: Net Realized Losses on Interest Rate Hedges	Economic Net Interest Income (1)
For the Quarter Ended September 30, 2014	\$ 190,355	\$ 38,886	\$ 17,132	\$ 56,018	\$ 151,469	\$ 17,132	\$ 134,333
For the Quarter Ended June 30, 2014	\$ 134,318	\$ 20,680	\$ 12,061	\$ 32,741	\$ 113,638	\$ 12,061	\$ 101,573
For the Quarter Ended March 31, 2014	\$ 120,667	\$ 22,425	\$ 5,650	\$ 28,075	\$ 98,242	\$ 5,650	\$ 92,588
For the Quarter Ended December 31, 2013	\$ 128,062	\$ 21,485	\$ 5,477	\$ 26,962	\$ 106,577	\$ 5,477	\$ 101,092
For the Quarter Ended September 30, 2013	\$ 130,361	\$ 25,074	\$ 5,459	\$ 30,533	\$ 105,287	\$ 5,459	\$ 99,824

(1) Excludes interest income on cash and cash equivalents.

## Net Interest Rate Spread

The following table shows our average earning assets held, interest earned on assets, yield on average interest earning assets, average debt balance, economic interest expense, economic average cost of funds, economic net interest income, and net interest rate spread for the periods presented.



	For the Quarter Ended					
	September 30, 2014			September 30, 2013		
	(dollars in thousands)					
	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
Assets:						
Interest-earning assets						
(1):						
Agency RMBS	\$ 7,614,237	\$ 64,065	3.37 %	\$ 2,061,276	\$ 16,599	3.22 %
Non-Agency RMBS	812,667	22,544	11.10 %	671,713	22,215	13.23 %
Non-Agency RMBS transferred to consolidated VIEs	1,787,994	71,108	15.91 %	2,217,071	82,776	14.93 %
Jumbo Prime securitized residential mortgage loans held for investment	710,865	5,282	2.97 %	885,965	8,767	3.96 %
Seasoned sub-prime securitized residential mortgage loans held for investment	1,556,948	27,352	7.03 %	-	-	-
Total	\$ 12,482,712	\$ 190,351	6.10 %	\$ 5,836,025	\$ 130,357	8.93 %
Liabilities and stockholders' equity:						
Interest-bearing liabilities:						
Agency repurchase agreements (2)	\$ 7,181,000	\$ 23,872	1.33 %	\$ 1,533,733	\$ 7,039	1.84 %
Non-Agency repurchase agreements	560,836	3,162	2.26 %	-	-	-
Securitized debt, collateralized by Non-Agency RMBS	765,028	13,540	7.08 %	1,067,709	16,909	6.33 %
Securitized debt, collateralized by jumbo prime residential mortgage loans	588,699	5,205	3.54 %	759,066	6,585	3.47 %
Securitized debt, collateralized by seasoned sub-prime residential mortgage loans	1,255,689	10,239	3.26 %	-	-	-
Total	\$ 10,351,252	\$ 56,018	2.16 %	\$ 3,360,508	\$ 30,533	3.63 %
Net economic interest income/net interest rate spread		\$ 134,333	3.93 %		\$ 99,824	5.29 %

Net interest-earning assets/net interest margin	\$ 2,131,460	4.30 %	\$ 2,475,518	6.84 %
---	--------------	--------	--------------	--------

Ratio of interest-earning assets to interest bearing liabilities	1.21	1.74
--	------	------

(1) Interest-earning assets at amortized cost

(2) Interest includes cash paid on swaps

	For the Nine Months Ended					
	September 30, 2014			September 30, 2014		
	(dollars in thousands)					
	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
<b>Assets:</b>						
<b>Interest-earning assets (1):</b>						
Agency RMBS	\$ 4,321,091	\$ 109,322	3.37 %	\$ 1,850,327	\$ 47,391	3.41 %
Non-Agency RMBS	796,297	61,791	10.35 %	646,741	54,093	11.15 %
Non-Agency RMBS transferred to consolidated VIEs	1,921,600	225,417	15.64 %	2,309,704	257,107	14.84 %
Jumbo Prime securitized residential mortgage loans held for investment	742,858	21,446	3.85 %	1,044,492	25,100	3.20 %
Seasoned sub-prime securitized residential mortgage loans held for investment	518,983	27,352	7.03 %	-	-	-
<b>Total</b>	<b>\$ 8,300,829</b>	<b>\$ 445,328</b>	<b>10.73 %</b>	<b>\$ 5,851,263</b>	<b>\$ 383,691</b>	<b>13.11 %</b>
<b>Liabilities and stockholders' equity:</b>						
<b>Interest-bearing liabilities:</b>						
Agency repurchase agreements (2)	\$ 3,921,089	\$ 46,036	1.57 %	\$ 1,503,967	\$ 21,422	1.90 %
Non-Agency repurchase agreements	246,603	3,939	2.13 %	-	-	-
Securitized debt, collateralized by Non-Agency RMBS	823,113	39,559	6.41 %	1,178,244	54,161	6.13 %
Securitized debt, collateralized by jumbo prime residential mortgage loans	621,142	17,061	3.66 %	911,861	21,311	3.12 %
Securitized debt, collateralized by seasoned sub-prime residential mortgage loans	418,563	10,239	3.26 %	-	-	-
<b>Total</b>	<b>\$ 6,030,510</b>	<b>\$ 116,834</b>	<b>3.87 %</b>	<b>\$ 3,594,071</b>	<b>\$ 96,894</b>	<b>5.39 %</b>

Net economic interest income/net interest rate spread	\$ 328,494	6.85 %	\$ 286,797	7.72 %
Net interest-earning assets/net interest margin	\$ 2,270,318	7.91 %	\$ 2,257,192	9.80 %
Ratio of interest-earning assets to interest bearing liabilities	1.38		1.63	
(1) Interest-earning assets at amortized cost				
(2) Interest includes cash paid on swaps				

#### Net Economic Interest Income and the Average Earning Assets

Our net economic interest income increased by \$34 million to \$134 million for the quarter ended September 30, 2014 from \$100 million for the same period of 2013. Our net interest rate spread, which equals the yield on our average assets less the economic average cost of funds decreased by 136 basis points for the quarter ended September 30, 2014 as compared to the same period of 2013. The net interest margin, which equals the net economic interest income as a percentage of the net average balance of our interest-earning assets less our interest-bearing liabilities, decreased by 254 basis points for the quarter ended September 30, 2014 as compared to the same period of 2013. Our net interest margin declined due to a lower total average yield on our interest-earning assets of 284 basis points which was not fully offset by the decline in our average cost of funds of 146 basis points. The portfolio has experienced changes in 2014 as compared to 2013 as we have increased our average Agency RMBS and securitized loans held for investment and our Non-Agency RMBS has declined. To finance these increase, we have primarily increased our repurchase agreements and securitized debt. These financing increases used to purchase additional interest-earning assets have increased our leverage ratios, resulting in an overall increase in our return on equity.

Our net economic interest income increased by \$41 million to \$328 million for the nine months ended September 30, 2014 from \$287million for the same period of 2013. Our net interest rate spread, which equals the yield on our average assets less the economic average cost of funds decreased by 40 basis points for the nine months ended September 30, 2014 as compared to the same period of 2013. The net interest margin, which equals the net economic interest income as a percentage of the net average balance of our interest-earning assets less our interest-bearing liabilities, decreased by 189 basis points for the nine months ended September 30, 2014 as compared to the same period of 2013. The decline in our net interest margin for the nine month period is consistent with the decline for the quarter; however, as the increase in Agency RMBS and securitized debt and repurchase agreements occurred during the second half of the nine month period, the impact on the nine month period is less significant.

Our average interest-earning assets increased by \$6.6 billion, or 114%, for the quarter ended September 30, 2014 as compared to the same period of 2013. Our average interest-earning assets increased by \$2.4 billion, or 42%, for the nine months ended September 30, 2014 as compared to the same period of 2013. We will continue to expand our holdings as we identify favorable opportunities in the market.

#### Economic Interest Expense and the Cost of Funds

The borrowing rate at which we are able to finance our assets using repurchase agreements is typically correlated to LIBOR and the term of the financing. The table below shows our average borrowed funds, economic interest expense, average cost of funds (inclusive of realized losses on interest rate swaps), average one-month LIBOR, average six-month LIBOR, average one-month LIBOR relative to average six-month LIBOR, and average cost of funds relative to average one- and six- month LIBOR.

	Average Debt Balance	Economic Interest Expense (1)	Average Cost of Funds	Average One-Month LIBOR	Average Six-Month LIBOR	Average Six-Month LIBOR Relative to Average One-Month LIBOR	Average Cost of Funds Relative to Average One-Month LIBOR	Average Cost of Funds Relative to Average Six-Month LIBOR
(Ratios have been annualized, dollars in thousands)								
For The Quarter Ended September 30, 2014	\$10,351,252	\$ 56,018	2.16 %	0.15 %	0.33 %	(0.17 %)	2.01 %	1.84 %
For The Quarter Ended June 30, 2014	\$4,483,572	\$ 32,741	2.92 %	0.15 %	0.32 %	(0.17 %)	2.77 %	2.60 %
For The Quarter Ended March 31, 2014	\$3,145,025	\$ 28,075	3.57 %	0.16 %	0.33 %	(0.17 %)	3.41 %	3.24 %
For The Quarter Ended December 31, 2013	\$3,285,584	\$ 26,962	3.28 %	0.17 %	0.35 %	(0.18 %)	3.11 %	2.93 %
For The Quarter Ended September 30, 2013	\$3,360,508	\$ 30,533	3.63 %	0.19 %	0.39 %	(0.20 %)	3.44 %	3.24 %

(1) Includes effect of realized losses on interest rate swaps.

Average interest-bearing liabilities increased by \$7.0 billion, or 208%, for the quarter ended September 30, 2014 as compared to the same period of 2013. Economic interest expense increased by \$26 million, or 84%, for the quarter ended September 30, 2014 as compared to the same period of 2013. The increase in average interest-bearing liabilities is a result of the increase in leverage from repurchase agreements and securitized debt entered into during the second and third quarters of 2014, offset by declines in our securitized debt collateralized by Non-Agency RMBS. The additional financing was used to increase our Agency RMBS and secured residential mortgage loans. As our average interest-bearing liabilities increased, we have had an increase in interest expense. Lower interest rates in the 2014 as compared to the same period of 2013 have offset some of the increase in interest expense. We note that average one-month and six month LIBOR are down 4 basis points and 6 basis points in the third quarter of 2014 as compared to the same period of 2013. While we do acquire interest rate hedges to mitigate changes in interest rate risks, the hedges may not fully offset interest expense movements.

Average interest-bearing liabilities increased by \$3.3 billion, or 91%, for the nine months ended September 30, 2014 as compared to the same period of 2013. Economic interest expense increased by \$20 million, or 21%, for the nine months ended September 30, 2014 as compared to the same period of 2013. The increase in average interest-bearing liabilities is a result of the increase in leverage from repurchase agreements and securitized debt entered into during the second quarter and third quarters of 2014, offset by declines in our securitized debt collateralized by Non-Agency RMBS. Economic interest expense was also affected by the lower LIBOR interest rates and declines in our securitized debt collateralized by Non-Agency RMBS which offset the increase in the average interest-bearing liabilities.



## Net other-than-temporary credit impairment losses

OTTI losses are generated when fair values decline below our amortized cost basis, an unrealized loss, and the expected future cash flows decline from prior periods, an adverse change. When an unrealized loss and an adverse change in cash flows occur, we will recognize an OTTI loss in earnings. In addition, if we intend to sell a security, or believe we will be required to sell, a security in an unrealized loss position, we will recognize an OTTI loss in earnings equal to the unrealized loss.

OTTI losses were \$2 million and \$16 million for each of the quarters ended September 30, 2014 and 2013, respectively. OTTI losses were \$9 million and \$23 million for each of the nine months ended September 30, 2014 and 2013, respectively. As of September 30, 2014, we had three securities in an unrealized loss position totaling less than \$1 million for which we did not recognize impairment. We intend to hold these securities until they recover their amortized cost. We continue to monitor our investment portfolio and will impair all investments in an unrealized loss position for which we do not believe we will recover our amortized cost prior to maturity or sale.

## Net gains (losses) on derivatives

The table below shows a summary of our gain (loss) on derivative instruments, net for the quarters and nine months ended September 30, 2014 and 2013.

	For the Quarter Ended			
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Periodic interest cost of interest rate swaps, net	\$ (17,132 )	\$ (5,459 )	\$ (34,843 )	\$ (16,380 )
Realized gain (loss) on derivative instruments, net:				
	(dollars in thousands)			
Mortgage Options	5,852	3,590	7,505	3,590
Treasury Futures	(11,547 )	(1,522 )	(21,029 )	(1,522 )
Swaptions	(325 )	-	(325 )	-
Total realized gain (loss) on derivative instruments, net	(6,020 )	2,068	(13,849 )	2,068
Unrealized gain on derivative instruments, net:				
Interest Rate Swaps	7,041	\$ 237	(8,729 )	18,817
Mortgage Options	(4,340 )	(198 )	-	(198 )
Treasury Futures	10,436	(12 )	(2,829 )	(12 )
Swaptions	(162 )	-	(162 )	-
Total unrealized gain (loss) on derivative instruments, net:	12,975	27	(11,720 )	18,607
Total gain (loss) on derivative instruments, net	\$ (10,177 )	\$ (3,364 )	\$ (60,412 )	\$ 4,295

Our derivative portfolio includes interest rate swaps, Treasury futures, and mortgage options. During the nine months ended September 30, 2014, we entered into 27 new interest rate swap agreements with a notional value of \$2.0 billion,

all of which were added during the second quarter of 2014. We also increased our Treasury futures positions by \$680 million of notional value during the nine months ended September 30, 2014. The new swaps and Treasury futures are primarily related to the increase in Agency RMBS financed primarily with new repurchase agreements to mitigate the effects of changes in interest rates on our portfolio.

During the quarter ended September 30, 2014, we recognized net losses on derivatives of \$10 million compared to net losses of \$3 million for the same period of 2013. During the nine months ended September 30, 2014, we recognized net losses on derivatives of \$60 million compared to net gains of \$4 million for the same period of 2013. The net gains and losses on our derivatives include both unrealized and realized gains and losses. Realized gains and losses include the net cash paid and received on our interest rate swaps during the period as well as sales and settlements of our Treasury futures and mortgage options. Unrealized gains and losses include the change in market value, period over period, on our derivatives portfolio. We may or may not ultimately realize these unrealized derivative gains and losses depending on trade activity, changes in interest rates and the values of the underlying securities.

Our interest rate swaps are primarily used to economically hedge the effects of changes in interest rates on our portfolio specifically our floating rate debt. Therefore, we included the periodic interest costs of the interest rate swaps for the quarters and nine month periods ended September 30, 2014 and 2013 on these economic hedges in our presentation of economic net interest income and our net interest spreads. As we do not account for these as hedges for GAAP presentation, we present these gains and losses separately in the consolidated statements of operations and comprehensive income. The increase in the net periodic interest cost of the interest rate swaps are primarily due to declines in interest rates year over year as we pay a fixed rate on our interest rate swaps and are receiving a lower floating rate.

Treasury futures are not included in our economic interest expense and economic net interest income. We also do not include any gains or losses on our mortgage options in our economic interest expense and economic net interest income as the mortgage options were sold for income generation and not as an economic hedge for changes in interest rates in our portfolio. As we identify opportunities in mortgage backed securities market, we may from time to time purchase or sell mortgage options, including both call and put options to take advantage of these opportunities. The realized gains on our mortgage options for the quarter and nine months ended September 30, 2014 was \$6 and \$8 million, respectively. We had no mortgage options during the quarter and nine months ended September 30, 2013.

#### Net Unrealized Gains (Losses) on Financial Instruments at Fair Value

We have elected a fair value option with changes in fair value reflected in earnings for our Agency and Non-Agency IO RMBS securities, certain of our securitized loans held for investment, collateralized by a seasoned sub-prime pool of residential mortgage loans, and the related financing for the securitized loans consolidated as a VIE in our statement of financial condition. The table below shows the unpaid principal, fair value and impact of change in fair value on each of these financial instruments:

	As of September 30, 2014 (dollars in thousands)		As of September 30, 2013 (dollars in thousands)		For the Quarter Ended September 30, 2013 (dollars in thousands)	
	Unpaid Principal/ Notional	Fair Value	Unpaid Principal/ Notional	Fair Value	Gain/(Loss) on Change in Fair Value	Gain/(Loss) on Change in Fair Value
IO RMBS securities	7,663,118	335,773	6,794,462	336,373	(5,599 )	(27,874 )
Securitized loans held for investment, at fair value	4,748,160	4,816,551	-	-	139,020	-
Securitized debt at fair value, collateralized by loans held for investment	3,842,420	3,737,602	-	-	29,500	-
Total gain (loss) on financial instruments, net	\$ 16,253,698	\$ 8,889,926	\$ 6,794,462	\$ 336,373	\$ 162,921	\$ (27,874 )

Unrealized gains and losses on our Agency and Non-Agency IO RMBS portfolio represent the change in fair value the security from the prior period. Unrealized gains and losses on our entire Agency and Non-Agency IO RMBS portfolio are reflected in earnings. IO securities represent the right to receive the interest on a pool of mortgage

backed securities, including both Agency and Non-Agency mortgage pools. The fair value of IO RMBS securities are heavily impacted by changes in expected prepayment rates. When IO securities prepay, the holder of the IO security will receive less interest on the investment due to the reduced principal.

The securitized loans at fair value were acquired during the third quarter of 2014. We consolidated the securitized debt at fair value, collateralized by loans held for investment, onto our statement of financial condition during the third quarter of 2014. This debt represents the obligations of the certain consolidated VIEs which are not held by us and are collateralized by the portfolio of seasoned sub-prime residential mortgage loans.

#### Gains and Losses on Sales of Assets and Loss on extinguishment of securitized debt

Net realized gains on sales of investments were \$64 million for the quarter ended September 30, 2014 compared to realized gains of \$19 million for the same period of the prior year. Net realized gains on sales of investments were \$68 million for the nine months ended September 30, 2014 compared to realized gains of \$73 million for the same period of the prior year.

We do not forecast sales of investments as we generally expect to invest for long term gains, however, from time to time, we may sell assets to achieve targeted leverage ratios as well as for gains when prices indicate a sale is most beneficial to us, or is the most prudent course of action to maintain a targeted risk adjusted yield for our investors.

During the second quarter of 2014, we recognized \$48 million of gains on sales on \$284 million of holdings related to consolidated VIEs. The gain on sale of VIE assets is included in Gain on deconsolidation in the Consolidated Statement of Operations and Comprehensive Income.

During the first quarter of 2014, the company purchased \$54 million of securitized debt collateralized by non-agency RMBS for cash payments of \$56 million. When the Company acquires its outstanding debt, it extinguishes the outstanding debt and recognizes a gain or loss based on the difference between the carrying value of the debt and the cost to acquire the debt. This acquisition resulted in a net loss of \$2 million which is reflected in the Consolidated Statement of Operations and Comprehensive Income as a loss on extinguishment of debt during the nine months ended September 30, 2014.

#### Net Management Fees and General and Administrative Expenses

The table below shows our total management fee and general and administrative, or G&A, expenses as compared to average total assets and average equity for the periods presented.

	Total Management Fee and G&A Expenses	Total Management Fee and G&A Expenses/Total Assets	Total Management Fee and G&A Expenses/Average Equity
(Ratios have been annualized, dollars in thousands)			
For The Quarter Ended September 30, 2014 (1)	\$ 13,178	0.43 %	1.54 %
For The Quarter Ended June 30, 2014	\$ 10,317	0.42 %	1.22 %
For The Quarter Ended March 31, 2014	\$ 9,276	0.54 %	1.11 %
For The Quarter Ended December 31, 2013	\$ 8,965	0.51 %	1.04 %
For The Quarter Ended September 30, 2013	\$ 9,112	0.51 %	1.01 %

(1) Does not include one-time management fee reduction of \$24 million

We incurred management fees of \$9 million and \$6 million for each of the quarters ended September 30, 2014 and 2013, respectively. We also recognized reimbursements from our manager related to the amended management agreement of \$2 million and \$3 million for the quarters ended September 30, 2014 and 2013. We incurred management fees of \$22 million and \$20 million for the nine months ended September 30, 2014 and 2013, respectively. We recognized reimbursements from our manager related to the amended management agreement of \$5 million for the nine months ended September 30, 2014 and 2013. The management fee is based on our stockholders' equity as defined in the investment management agreement. See further discussion of the management fee, including amendments to the management agreement, as well as other agreements with our Manager in our discussion of related party transactions below.

G&A expenses were \$6 million and \$4 million for the quarters ended September 30, 2014 and 2013 and \$16 million and \$14 million for each of the nine month periods ended September 30, 2014 and 2013. Our G&A expenses have remained consistent period over period. Additionally, during the third quarter of 2014, our manager agreed to pay us a one time payment of approximately \$24 million.

#### Provision for Loan Losses

The provision for loan losses related to our prime jumbo securitized loans held for investment at amortized cost represents managements estimate of expected future cash flows on the securitized loans held. The provision in 2014 declined by an insignificant amount. We do not expect significant changes in our loan loss provision as the total loans held for investment portfolio continues to decline as a result of principal repayments.

The seasoned sub-prime residential mortgage loans consolidated during the third quarter are carried at fair value with changes in fair value reflected in earnings and, therefore, do not have a provision for loan losses. Credit changes are rather reflected in the change in fair value recorded in earnings.

#### Net Income (Loss) and Return on Average Equity

The table below shows our economic net interest income, realized gains (losses) on sale of assets and the credit related OTTI, realized and unrealized gains (losses) on interest rate swaps and IOs, total management fee and G&A expenses, and income tax, each as a percentage of average equity, and the return on average equity for the periods presented.

	Economic Net Interest Income/Average Equity *	Realized Gains (Losses) on Sales and OTTI/Average Equity	Realized and Unrealized Gains (Losses) on Interest Rate Swaps and IOs/Average Equity	Total Management Fee & G&A Expenses/Average Equity	Return on Average Equity
(Ratios have been annualized)					
For The Quarter Ended September 30, 2014	15.64 %	7.41 %	2.57 %	(1.54 %)	43.99 %
For The Quarter Ended June 30, 2014	12.00 %	(1.17 %)	2.55 %	(1.22 %)	12.38 %
For The Quarter Ended March 31, 2014	11.04 %	0.78 %	1.31 %	(1.11 %)	11.98 %
For The Quarter Ended December 31, 2013	13.13 %	(3.12 %)	1.55 %	(1.04 %)	8.39 %
For The Quarter Ended September 30, 2013	11.33 %	0.27 %	(3.10 %)	(1.01 %)	7.49 %

\* Includes effect of realized losses on interest rate swaps.

Our net income was \$378 million and \$67 million for the quarters ended September 30, 2014 and 2013, respectively. Economic net interest income as a percentage of average equity increased by 364 basis points for the quarter ended September 30, 2014 as compared to the same period of 2013. The increase in our economic net interest income as a percentage of average equity is due to an increase in interest earned, net of economic interest expense, on assets over the prior year as we have increased our leverage to enhance net economic interest income. The return on average equity increased significantly for the quarter ended September 30, 2014 as compared to the same period of 2013. The increase in our return on average equity is primarily due to higher income as a result of gains on financial instruments carried at fair value with changes in fair value reflected in earnings.

#### Core earnings

Our core earnings were \$116 million, or \$0.11 per average basic common share, for the quarter ended September 30, 2014 compared to \$93 million, or \$0.09 per average basic common share, for the same period in 2013. We attribute the majority of the increase in core earnings for the quarter ended September 30, 2014 from the quarter ended September 30, 2013 to the increase in net interest income from the acquisition of additional Agency RMBS during the second and third quarters of 2014. Our core earnings were \$282 million, or \$0.27 per average basic common share, for the nine months ended September 30, 2014 compared to \$263 million, or \$0.26 per average basic common share, for the same period in 2013. We attribute the majority of the increase in core earnings for the nine months ended September 30, 2014 from the nine months ended September 30, 2013 to the increase in net interest income from the acquisition of additional Agency RMBS during the second and third quarters of 2014.

Core earnings is a non-GAAP measure and is defined as GAAP net income (loss) excluding unrealized gains on the aggregate portfolio, impairment losses, realized gains on sales of investments, gain on deconsolidation, extinguishment of debt and certain other non-recurring gains or losses. As defined, Core earnings includes interest

income and expense as well as realized gains or losses on derivatives used to hedge interest rate risk. Core earnings is provided for purposes of comparability to other peer issuers, but has important limitations. Core Earnings as described above helps evaluate our financial performance without the impact of certain transactions and is of limited usefulness as an analytical tool. Therefore, core earnings should not be viewed in isolation and is not a substitute for net income or net income per basic share computed in accordance with GAAP.

The following table provides GAAP measures of net income (loss) and net income (loss) per basic share available to common stockholders for the quarters and nine months ended September 30, 2014 and 2013 and details with respect to reconciling the line items to core earnings and related per average basic common share amounts:

	For the Quarter Ended		For the Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
GAAP Net income (loss)	\$ 377,580	\$ 67,367	\$ 582,717	\$ 290,375
Adjustments:				
Net other-than-temporary credit impairment losses	1,990	16,455	8,871	22,618
Net unrealized (gains) losses on derivatives	(12,975 )	(27 )	11,720	(18,607 )
Total other (gains) losses	(227,028 )	9,058	(297,529 )	(31,078 )
Other (income) expense	(23,783 )	-	(23,783 )	-
Core Earnings	\$ 115,784	\$ 92,853	\$ 281,966	\$ 263,308
GAAP net income per basic common share	\$ 0.37	\$ 0.07	\$ 0.57	\$ 0.28
Core earnings per basic common share	\$ 0.11	\$ 0.09	\$ 0.27	\$ 0.26

## Liquidity and Capital Resources

### General

Liquidity measures our ability to meet cash requirements, including ongoing commitments to repay our borrowings, purchase RMBS, mortgage loans and other assets for our portfolio, pay dividends and other general business needs. Our principal sources of capital and funds for additional investments primarily include earnings from our investments, borrowings under securitizations and re-securitizations, repurchase agreements and other financing facilities, and proceeds from equity offerings.

To meet our short term (one year or less) liquidity needs, we expect to continue to borrow funds in the form of repurchase agreements and, subject to market conditions, other types of financing. The terms of the repurchase transaction borrowings under our master repurchase agreements generally conform to the terms in the standard master repurchase agreement as published by the Securities Industry and Financial Markets Association, or SIFMA, as to repayment, margin requirements and the segregation of all securities we have initially sold under the repurchase transaction. In addition, each lender typically requires that we include supplemental terms and conditions to the standard master repurchase agreement. Typical supplemental terms and conditions include changes to the margin maintenance requirements, cross default provisions, required haircuts (or the percentage that is subtracted from the value of RMBS that collateralizes the financing), purchase price maintenance requirements, and requirements that all disputes related to the repurchase agreement be litigated or arbitrated in a particular jurisdiction. These provisions may differ for each of our lenders.



We expect to meet our short term liquidity needs by relying on the cash flows generated by our investments. These cash flows are primarily comprised of monthly principal and interest payments received on our investments. We may also sell our investments and utilize those proceeds to meet our short term liquidity needs or enter into non-recourse financing of our assets through sales of securities to third parties of loan securitizations or RMBS re-securitization transactions, similar to transactions that we have completed in prior periods.

Based on our current portfolio, leverage ratio and available borrowing arrangements, we believe our assets will be sufficient to enable us to meet anticipated short-term liquidity requirements. However, a decline in the value of our collateral could cause a temporary liquidity shortfall due to the timing of margin calls on the financing arrangements and the actual receipt of the cash related to principal paydowns. If our cash resources are at any time insufficient to satisfy our liquidity requirements, we may have to sell investments, potentially at a loss, or issue debt or additional equity securities in a common stock offering.

To meet our longer term liquidity needs (greater than one year), we expect our principal sources of capital and funds to continue to be provided by earnings from our investments, borrowings under securitizations and re-securitizations, repurchase agreements and other financing facilities, as well as proceeds from equity offerings. As a result of our failure to file our SEC filings by the filing date required by the SEC (including the grace period permitted by Rule 12b-25 under the Securities Exchange Act of 1934, as amended), we are not eligible to file a new Form S-3 registration statement or use our existing Form S-3 registration statements to raise additional equity capital until filings with the SEC have been timely made for a full year. Our ineligibility to use Form S-3 during this time period will have a negative impact on our ability to quickly access the public capital markets because we would be required to file a long-form registration statement and wait for the SEC to declare such registration statement effective.

In addition to the principal sources of capital described above, we may enter into warehouse facilities and use longer dated structured repurchase agreements. The use of any particular source of capital and funds will depend on market conditions, availability of these facilities, and the investment opportunities available to us.

#### Current Period

We held cash and cash equivalents of approximately \$242 million and \$78 million at September 30, 2014 and December 31, 2013, respectively.

Our operating activities provided net cash of approximately \$157 million and \$219 million for the nine months ended September 30, 2014 and 2013, respectively. The cash provided by our operations is primarily due to interest received in excess of interest paid during the period. During the first three months of 2014, interest received net of interest paid was \$315 million. During the first nine months of 2014, we paid cash to cover margin requirements on our interest rate swaps and other financial instruments of approximately \$112 million, which is primarily reflected in other assets and other payments from derivative sales and settlements during the nine months ended September 30, 2014.

Our investing activities used cash of approximately \$5.5 billion and provided cash of \$296 million for the nine months ended September 30, 2014 and 2013, respectively. During the nine months ended September 30, 2014 we purchased investments of \$7.8 billion, primarily Agency RMBS. This use of cash was offset during the period from sales of investments of \$2.4 billion and principal repayments of \$654 million during the first nine months of 2014. Additionally, during the third quarter of 2014, we used cash of \$774 million to acquire interests in a group of trusts collateralized by pools of seasoned sub-prime residential mortgage loans. During the nine months ended September 30, 2013, we received cash from principal repayments and sales of RMBS securities in our portfolio of \$1.3 billion and \$627 million respectively. This receipt of cash was offset by cash used of \$1.6 billion to acquire Agency and Non-Agency RMBS securities.

Our financing activities provided cash of \$5.5 billion and used cash of \$1 billion for the nine months ended September 30, 2014 and 2013, respectively. During the nine months ended September 30, 2014, we received proceeds on our repurchase agreements, net of repayments on our repurchase agreements of \$6.2 billion. These proceeds were offset by payments and repurchases on our securitized debt of \$564 million and payments of dividends of \$483 million. The payments of dividends during the nine months ended September 30, 2014 includes the \$205 million of special dividends announced in the fourth quarter of 2013, but paid during the first quarter of 2014. During the nine months ended September 30, 2013, we used cash for payments on securitized debt of \$795 million and paid dividends of \$277 million.

As a result of our operating, investing and financing activities described above, our cash position increased by \$164 million from December 31, 2013 to September 30, 2014. Our investments in Non-Agency RMBS and Agency RMBS, at fair value, increased by \$6.2 billion during the nine months ended September 30, 2014, not including assets of consolidated VIEs. The majority of these purchases were financed through repurchase agreements.

There were no secondary stock offerings during the nine months ended September 30, 2014 and 2013. Recourse leverage is 2.6:1 and 0.6:1 at September 30, 2014 and December 31, 2013. Our recourse leverage excludes the securitized debt which can only be repaid from the proceeds on the assets securing this debt in their respective VIEs. The increase in our recourse leverage is a result of the increase in repurchase agreements to primarily expand our Agency RMBS portfolio as well as to finance significant acquisitions of Non-Agency RMBS investment assets. Our recourse leverage is presented as a ratio to our economic net equity. We believe that this increased leverage will result in higher net income to our investors.

We believe that our cash balances provide an appropriate level of liquidity. Even though we have unrestricted Agency RMBS investments, we expect to meet our future cash needs primarily from principal and interest payments on our portfolio and do not anticipate we will need to sell unrestricted Agency RMBS investments to meet our liquidity needs. We expect to continue to finance our RMBS portfolio largely through repurchase agreements and loans through the securitization market. In addition, we may from time to time sell securities or issue debt as a source of cash to fund new purchases.

At September 30, 2014 and December 31, 2013, the remaining maturities on our RMBS repurchase agreements were as follows.

	September 30, 2014	December 31, 2013
	(dollars in thousands)	
Overnight	\$ -	\$ -
1-29 days	3,556,708	644,332
30 to 59 days	1,691,671	606,945
60 to 89 days	957,222	-
90 to 119 days	556,406	129,049
Greater than or equal to 120 days	1,076,156	278,235
Total	\$ 7,838,163	\$ 1,658,561
Average days to maturity	67 days	58 days

We collateralize the repurchase agreements we use to finance our operations with our RMBS investments. Our counterparties negotiate a 'haircut' when we enter into a financing transaction, which varies from lender to lender. The size of the haircut reflects the perceived risk associated with holding the RMBS by the lender. The haircut provides lenders with a cushion for daily market value movements that reduce the need for a margin call to be issued or margin to be returned as normal daily increases or decreases in RMBS market values occur. At September 30, 2014, the weighted average haircut on our repurchase agreements collateralized by Agency RMBS was 4.9%. The weighted average haircut on our repurchase agreements collateralized by Non-Agency RMBS was 29.6%. As the fair value of the Non-Agency RMBS is more difficult to determine, as well as more volatile period to period than Agency RMBS, the Non-Agency RMBS requires a larger haircut. Despite the haircut, repurchase agreements subject us to two types of margin calls. First, there are monthly margin calls that are triggered as principal payments and pre-payments are received by us as these payments lower the value of the collateral. As a result, we expect to receive margin calls from our repurchase counterparties monthly simply due to the principal paydowns on our Agency RMBS. The monthly principal payments and pre-payments are not known in advance and vary depending on the behavior of the borrowers related to the underlying mortgages. Second, counterparties make margin calls or return margin as a result of normal daily increases or decreases in asset fair values. In addition, when financing assets using standard form of SIFMA Master Repurchase Agreements, the counterparty to the agreement typically nets its exposure to us on all outstanding repurchase agreements and issues margin calls if movement of the fair values of the assets in the aggregate exceeds their allowable exposure to us. A decline in asset fair values could create a margin call, or may create no margin call depending on the counterparty's specific policy. In addition, counterparties consider a number of factors, including their aggregate exposure to us as a whole and the number of days remaining before the repurchase transaction closes prior to issuing a margin call. See Note 5 to our Consolidated Financial Statements for a discussion on how we determine the fair values of the RMBS collateralizing our repurchase agreements.

The table below presents our average daily repurchase balance and the repurchase balance at each period end for the periods presented. Our balance at period-end tends to have little fluctuation from the average daily balances except in periods where we are adjusting the size of our portfolio by using leverage as we did in the second and third quarter of

2014. Our average repurchase agreement balance at September 30, 2014 increased compared to our average repurchase agreement balance for the quarter ended December 31, 2013 due to additional borrowings on our repurchase agreements in excess of repayments during the first nine months of 2014. We continue to deploy capital for strategic purchases of investments.

Period	Average Repurchase Balance	Repurchase Balance at Period End
	(dollars in thousands)	
Quarter End September 30, 2014	\$ 7,741,837	\$ 7,838,163
Quarter End June 30, 2014	\$ 3,054,737	\$ 5,564,554
Quarter End March 31, 2014	\$ 1,648,425	\$ 1,561,920
Quarter Ended December 31, 2013	\$ 1,574,872	\$ 1,658,561
Quarter Ended September 30, 2013	\$ 1,464,677	\$ 1,589,325

We are not required to maintain any specific debt-to-equity ratio. We believe the appropriate leverage for the particular assets we are financing depends on the credit quality and risk of those assets. At September 30, 2014 and December 31, 2013 our total debt was approximately \$13.7 billion and \$3.3 billion, including payables for securities, which represented a debt-to-equity ratio of approximately 3.8:1 and 1.0:1, respectively. We include repurchase agreements and securitized debt in the numerator of our debt-to-equity ratio and stockholders' equity as the denominator.

We do not manage our portfolio to have a pre-designated amount of borrowings at quarter-end or year-end. Our borrowings at period end are a snapshot of borrowing as of a date, and this number should be expected to differ from average borrowings over the period. Our borrowings will change as we implement our portfolio and risk management strategies to address changing market conditions by increasing or decreasing leverage. Our borrowings may change during periods when we raise capital, and in certain instances we may purchase additional assets and increase borrowings prior to an expected capital raise. Since our average borrowings and period end borrowings can be expected to differ, we believe our average borrowings during a period provide a more accurate representation of our exposure to the risks associated with leverage.

During the second and third quarter of 2014, we increased our leverage through increased repurchase agreements. During the second quarter of 2014 we added four new repurchase agreement counterparties and increased our repurchase agreement obligations with 9 other counterparties. At September 30, 2014, we have repurchase agreements with 14 counterparties. All of our repurchase agreements are secured by Agency and Non-Agency RMBS. Under these repurchase agreements we may not be able to reclaim our collateral but still be obligated to pay our repurchase obligations. We mitigate this risk by limiting our exposure to any counterparty to less than 15% of our total equity as well as ensuring all our counterparties are highly rated. Therefore, we believe the risk of loss of our collateral posted is mitigated by the terms of our agreements. As of September 30, 2014 and 2013, we have pledged \$8.5 billion and \$1.7 billion of securities against our repurchase agreement obligations.

Our repurchase agreements have original maturities ranging from 30 to 365 days. The average term on our repurchase agreements at September 30, 2014 is 111 days. We expect to renew each of our repurchase agreements at maturity. When we renew our repurchase agreements, there is a chance that we will not be able to obtain as favorable an interest rate as a result of rising rates. We offset the risk of our repurchase agreements primarily through the use of interest rate swaps. The average remaining maturities on our interest rate swaps range from 2 years to 20 years and have a weighted average maturity of approximately 11 years. We use these interest rate swaps to protect the portfolio from short term changes in interest rates. We currently have four swap counterparties. When our interest rate swaps are in a net loss position (expected cash payments are in excess of expected cash receipts on the swaps), we post collateral as required by the terms of our swap agreements. As of September 30, 2014, we have posted \$129 million of cash and securities as collateral to our swap counterparties.

#### Secured Debt Financing Transactions

During the third quarter of 2014, we acquired controlling interests in several trusts collateralized by seasoned sub-prime pools of residential mortgage loans. As we held the controlling interest, we consolidated the assets and liabilities, increasing our investments in mortgage loans by \$4.7 billion and secured debt by \$4.0 billion. The investment of \$774 million was financed through a combination of cash raised from sales of investments and additional repurchase agreements. During the third quarter, we refinanced the secured debt related to one of the consolidated trusts acquired during the quarter.

We did not re-securitize any RMBS or jumbo prime residential mortgage loans during the nine months ended September 30, 2013.

## Exposure to European Financial Counterparties

Our Agency RMBS are primarily financed with repurchase agreements. We secure our borrowings under these agreements by pledging our Agency RMBS as collateral to the lender. The collateral we pledge exceeds the amount of the borrowings under each agreement, typically with the extent of over-collateralization being at least 3% of the amount borrowed. If the counterparty to the repurchase agreement defaults on its obligations and we are not able to recover our pledged assets, we are at risk of losing the over-collateralized amount. The amount of this exposure is the difference between the amount loaned to us plus interest due to the counterparty and the fair value of the collateral pledged by us to the lender including accrued interest receivable on such collateral.

We also use interest rate swaps to manage our interest rate risks. Under these swap agreements, we pledge Agency RMBS as collateral as part of a margin arrangement for interest rate swaps that are in an unrealized loss position. If a swap counterparty were to default on its obligation, we would be exposed to a loss to the extent that the amount of our Agency RMBS pledged exceeded the unrealized loss on the associated swaps and we were not able to recover the excess collateral.

Over the past several years, several large European financial institutions have experienced financial difficulty and have been either rescued by government assistance or by other large European banks or institutions. Some of these financial institutions or their U.S. subsidiaries have provided us financing under repurchase agreements or we have entered into interest rate swaps with such institutions. We have entered into repurchase agreements and/or interest rate swaps with six counterparties as of September 30, 2014 that is either domiciled in Europe or is a U.S.-based subsidiary of a European-domiciled financial institution. The following table summarizes our exposure to such counterparties at September 30, 2014:

Country	Number of Counterparties	Repurchase Agreement Financing (dollars in thousands)	Interest Rate Swaps at Fair Value	Exposure (1)	Exposure as a Percentage of Total Assets
France	1	\$ 593,278	\$ (21,790 )	\$ 10,414	0.06%
Germany	1	-	(3,568 )	(3,568 )	-0.02%
Netherlands	1	491,294	-	20,910	0.12%
Switzerland	2	1,533,939	(13,569 )	356,720	2.04%
United Kingdom	1	545,590	-	8,026	0.05%
Total	6	\$ 3,164,101	\$ (38,927 )	\$ 392,501	2.25%

(1) Represents the amount of securities pledged as collateral to each counterparty less the aggregate of repurchase agreement financing and unrealized loss on swaps for each counterparty.

At September 30, 2014, we did not use credit default swaps or other forms of credit protection to hedge the exposures summarized in the table above.

If the European credit crisis continues to impact these major European financial institutions, it is possible that it will also impact the operations of their U.S. subsidiaries. Our financings and operations could be adversely affected by such events. We monitor our exposure to our repurchase agreement and swap counterparties on a regular basis, using various methods, including review of recent rating agency actions, financial relief plans, credit spreads or other developments and by monitoring the amount of cash and securities collateral pledged and the associated loan amount under repurchase agreements and/or the fair value of swaps with our counterparties. We make reverse margin calls on



our counterparties to recover excess collateral as permitted by the agreements governing our financing arrangements or interest rate swaps, or may try to take other actions to reduce the amount of our exposure to a counterparty when necessary.

#### Stockholders' Equity

On January 28, 2011, we entered into an equity distribution agreement with FIDAC and UBS Securities LLC, or UBS. Through this agreement, we may sell through UBS, as our sales agent, up to 125,000,000 shares of our common stock in ordinary brokers' transactions at market prices or other transactions as agreed between us and UBS. We did not sell any shares of our common stock under the equity distribution agreement during the quarters or nine months ended September 30, 2014 or 2013.

During the quarters ended September 30, 2014 and 2013, we declared dividends to common shareholders totaling \$92 million, or \$0.09 per share. During the nine months ended September 30, 2014 and 2013, we declared dividends to common shareholders totaling \$277 million, or \$0.27 per share.

The Board of Directors has determined that there will be a quarterly dividend of \$0.09 per share for the fourth quarter of 2014.

There was no preferred stock issued or outstanding as of September 30, 2014 and December 31, 2013.

#### Related Party Transactions

##### The Management Agreement

We entered into a management agreement with FIDAC, which provided for an initial term through December 31, 2010 with an automatic one-year extension option and subject to certain termination rights. Effective November 28, 2012, the management fee was reduced from 1.50% to 0.75% per annum of gross stockholders' equity, which remained in effect until we were current on all of its filings required under applicable securities laws.

On August 8, 2014, the management agreement was amended and restated. Effective August 8, 2014, the management fee was increased to 1.20% of gross stockholders' equity. In addition, FIDAC agreed to pay us a one-time payment of approximately \$24 million to resolve issues raised in derivative demand letters sent to our Board of Directors. This amount equals a base management fee equal to 0.75% per annum of gross stockholders' equity as if it were in effect from January 1, 2012 through November 27, 2012. This payment was received by the Company during the third quarter of 2014 and is included in Other income in the Consolidated Statement of Operations.

The agreement provides for a two year term ending August 7, 2016 and may be automatically renewed for two year terms at each anniversary date unless at least two-thirds of the independent directors or the holders of a majority of the outstanding shares of common stock elects not to renew the agreement in their sole discretion and for any or no reason. Unless the management agreement is terminated for "cause" or FIDAC terminates the management agreement, in the event that the management agreement is terminated or not renewed, we must pay to FIDAC a termination fee equal to two times the average annual management fee, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination. FIDAC will continue to provide services under the management agreement for a period not less than 180 days from the date the Company delivers the notice not to renew the management agreement.

We may also terminate the management agreement with 30 days' prior notice from our board of directors, without payment of a termination fee, for cause or upon a change of control of FIDAC or Annaly Capital Management, Inc. (the parent of FIDAC), each as defined in the management agreement. FIDAC may terminate the management agreement if we become required to register as an investment company under the Investment Company Act of 1940, as amended, with such termination deemed to occur immediately before such event, in which case we would not be required to pay a termination fee. FIDAC may also decline to renew the management agreement by providing us with 180-days' written notice, in which case we would not be required to pay a termination fee.

The management agreement provides that FIDAC will pay all past and future expenses that we and/or our Audit Committee incur to: (1) evaluate our accounting policy related to the application of GAAP to our Non-Agency RMBS portfolio (the "Evaluation"); (2) restate our financial statements for the period covering 2008 through 2011 as a result of the Evaluation (the "Restatement Filing"); and (3) investigate and evaluate any shareholder derivative demands arising from the Evaluation and/or the Restatement Filing (the "Investigation"); provided, however, that FIDAC's obligation to pay expenses applies only to expenses not paid by our insurers under our insurance policies. Expenses shall include,

without limitation, fees and costs incurred with respect to auditors, outside counsel, and consultants engaged by us and/or our Audit Committee for the Evaluation, Restatement Filing and the Investigation. The amount paid by FIDAC related to these expenses for the quarters ended September 30, 2014 and 2013 is \$2 million and \$3 million, respectively, and is presented in the Consolidated Statements of Operations and Comprehensive Income (Loss) as Expense recoveries from Manager. The amount paid by FIDAC related to these expenses for both of the Nine months ended September 30, 2014 and 2013 is \$5 million, respectively.

We are obligated to reimburse FIDAC for costs incurred on our behalf under the management agreement. In addition, the management agreement permits FIDAC to require us to pay for our pro rata portion of rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses that FIDAC incurred in connection with our operations. These expenses are allocated between FIDAC and us based on the ratio of our proportion of gross assets compared to the gross assets managed by FIDAC as calculated at each quarter end. We and FIDAC will modify this allocation methodology, subject to the approval of our board of directors if the allocation becomes inequitable (i.e., if we become very highly leveraged compared to FIDAC's other funds and accounts). The reimbursements to FIDAC are less than \$1 million for the quarter and nine months ended September 30, 2014.

#### Clearing Fees

On March 1, 2011, we entered into an administrative services agreement with RCap Securities, Inc., or RCap. We use RCap, a SEC registered broker-dealer and a wholly-owned subsidiary of Annaly, to clear trades for us and RCap is paid customary fees in return for such services. RCap may also provide brokerage services to us from time to time. The fees paid to RCap are less than \$1 million for the quarter and nine months ended September 30, 2014.

#### Restricted Stock Grants

We granted 1,301,000 shares of restricted stock to employees of our Manager and its affiliates and members of our board of directors on January 2, 2008. At September 30, 2014 and December 31, 2013, there were approximately 214,000 and 384,000 unvested shares of restricted stock issued to employees of FIDAC, respectively.

#### Contractual Obligations and Commitments

The following tables summarize our contractual obligations at September 30, 2014 and December 31, 2013. The estimated principal repayment schedule of the securitized debt is based on expected cash flows of the residential mortgage loans or RMBS, as adjusted for expected principal writedowns on the underlying collateral of the debt.

September 30, 2014					
(dollars in thousands)					
Contractual Obligations	Within One Year	One to Three Years	Three to Five Years	Greater Than or Equal to Five Years	Total
Repurchase agreements for RMBS	\$ 7,838,163	\$ -	\$ -	\$ -	\$ 7,838,163
Securitized debt	858,050	1,346,397	910,604	1,811,101	4,926,152
Interest expense on RMBS repurchase agreements (1)	12,432	3	-	-	12,435
Interest expense on securitized debt (1)	185,214	313,475	245,471	643,507	1,387,666
<b>Total</b>	<b>\$ 8,893,858</b>	<b>\$ 1,659,876</b>	<b>\$ 1,156,074</b>	<b>\$ 2,454,608</b>	<b>\$ 14,164,416</b>

(1) Interest is based on variable rates in effect as of September 30, 2014.

December 31, 2013	
(dollars in thousands)	
Within One	Total

Contractual Obligations	Year	One to Three Years	Three to Five Years	Greater Than or Equal to Five Years	
Repurchase agreements for RMBS	\$ 1,658,561	\$ -	\$ -	\$ -	\$ 1,658,561
Securitized debt	370,250	497,943	264,456	396,916	1,529,565
Interest expense on RMBS repurchase agreements (1)	2,380	-	-	-	2,380
Interest expense on securitized debt (1)	57,546	80,446	58,620	178,391	375,003
<b>Total</b>	<b>\$ 2,088,737</b>	<b>\$ 578,389</b>	<b>\$ 323,076</b>	<b>\$ 575,307</b>	<b>\$ 3,565,509</b>

(1) Interest is based on variable rates in effect as of December 31, 2013.

#### Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide funding to any such entities.

## Capital Requirements

At September 30, 2014 and December 31, 2013, we have committed to acquire all interests of a new resecuritization vehicle collateralized with loans acquired during the third quarter of 2014. The commitment is \$348 million as of September 30, 2014, however, we expect that a majority of the interests in this new securitization vehicle will be acquired by unrelated third parties.

## Dividends

To qualify as a REIT, we must pay annual dividends to our stockholders of at least 90% of our taxable income (subject to certain adjustments). We intend to pay regular quarterly dividends to our stockholders. Before we pay any dividend, we must first meet any operating requirements and scheduled debt service on our financing facilities and other debt payable.

## Inflation

A significant portion of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our consolidated financial statements are prepared in accordance with GAAP and our distributions will be determined by our board of directors consistent with our obligation to distribute to our stockholders at least 90% of our REIT taxable income on an annual basis in order to maintain our REIT qualification; in each case, our activities and financial condition are measured with reference to historical cost and/or fair market value without considering inflation.

## Other Matters

We at all times intend to conduct our business so as not to become regulated as an investment company under the 1940 Act. If we were to become regulated as an investment company, our ability to use leverage would be substantially reduced.

Section 3(a)(1)(C) of the Investment Company Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer's total assets (exclusive of U.S. Government securities and cash items) on an unconsolidated basis (the "40% test"). Excluded from the term "investment securities," among other things, are securities issued by majority-owned subsidiaries that rely on the exemption from registration provided by Section 3(c)(5)(C) of the Investment Company Act.

Certain of our subsidiaries, including Chimera Asset Holding LLC and certain subsidiaries that we may form in the future, rely on the exemption from registration provided by Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C), as interpreted by the staff of the Securities and Exchange Commission (or the SEC), requires us to invest at least 55% of our assets in "mortgages and other liens on and interest in real estate" (or Qualifying Real Estate Assets) and at least 80% of our assets in Qualifying Real Estate Assets plus real estate related assets. The assets that we acquire, therefore, are limited by the provisions of and the rules and regulations promulgated under the Investment Company Act.

On August 31, 2011, the SEC issued a concept release titled "Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments" (SEC Release No. IC-29778). Under the concept release, the SEC is reviewing interpretive issues related to the Section 3(c)(5)(C) exemption. We are monitoring developments related to this matter.

Based on our calculations, as of September 30, 2014 and December 31, 2013, we were in compliance with the exemption from registration provided by Section 3(c)(5)(C) and 3(a)(1)(C) of the Investment Company Act.

As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the U.S. Commodity Futures Trading Commission, or CFTC, gained jurisdiction over the regulation of interest rate swaps. The CFTC has asserted that this causes the operators of mortgage real estate investment trusts that use swaps as part of their business model to fall within the statutory definition of Commodity Pool Operator, or CPO, and, absent relief from the Division or the Commission, to register as CPOs. On December 7, 2012, as a result of numerous requests for no-action relief from the CPO registration requirement for operators of mortgage real estate investment trusts, the Division of Swap Dealer and Intermediary Oversight of the CFTC issued no-action relief entitled “No-Action Relief from the Commodity Pool Operator Registration Requirement for Commodity Pool Operators of Certain Pooled Investment Vehicles Organized as Mortgage Real Estate Investment Trusts” that permits a CPO to receive relief by filing a claim to perfect the use of the relief. A claim submitted by a CPO will be effective upon filing, so long as the claim is materially complete. The conditions that must be met to claim the relief are that the mortgage real estate investment trust must:

Limit the initial margin and premiums required to establish its commodity interest positions to no more than five percent of the fair market value of the mortgage real estate investment trust’s total assets;

Limit the net income derived annually from its commodity interest positions that are not qualifying hedging transactions to less than five percent of the mortgage real estate investment trust’s gross income;

Ensure that interests in the mortgage real estate investment trust are not marketed to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures, commodity options, or swaps markets; and

•

Either:

- o identify itself as a “mortgage REIT” in Item G of its last U.S. income tax return on Form 1120-REIT; or
- o if it has not yet filed its first U.S. income tax return on Form 1120-REIT, disclose to its shareholders that it intends to identify itself as a “mortgage REIT” in its first U.S. income tax return on Form 1120-REIT.

While we disagree that the CFTC’s position that mortgage real estate investment trusts that use swaps as part of their business model fall within the statutory definition of a CPO, we have submitted a claim for the relief set forth in the no-action relief entitled “No-Action Relief from the Commodity Pool Operator Registration Requirement for Commodity Pool Operators of Certain Pooled Investment Vehicles Organized as Mortgage Real Estate Investment Trusts” and believe we meet the criteria for such relief set forth therein.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

#### Credit Risk

We are subject to credit risk in connection with our investments in Non-Agency RMBS and residential mortgage loans and face more credit risk on assets we own which are rated below “AAA.” The credit risk related to these investments pertains to the ability and willingness of the borrowers to pay, which is assessed before credit is granted or renewed and periodically reviewed throughout the loan or security term. We believe that residual loan credit quality, and thus



the quality of our assets, is primarily determined by the borrowers' credit profiles and loan characteristics. We use a comprehensive credit review process. Our analysis of loans includes borrower profiles, as well as valuation and appraisal data. We use compensating factors such as liquid assets, low loan to value ratios and regional unemployment statistics in evaluating loans. Our resources include a proprietary portfolio management system, as well as third party software systems. We may utilize a third party due diligence firm to perform an independent underwriting review to ensure compliance with existing guidelines. In addition to statistical sampling techniques, we create adverse credit and valuation samples, which we individually review. We reject loans that fail to conform to our standards and do not meet our underwriting criteria. Once we own a loan, our surveillance process includes ongoing analysis through our proprietary data and servicer files. Additionally, the Non-Agency RMBS and other ABS which we acquire for our portfolio are reviewed by us to ensure that they satisfy our risk based criteria. Our review of Non-Agency RMBS and other ABS includes utilizing a proprietary portfolio management system. Our review of Non-Agency RMBS and other ABS is based on quantitative and qualitative analysis of the risk-adjusted returns on Non-Agency RMBS and other ABS. This analysis includes an evaluation of the collateral characteristics supporting the RMBS such as borrower payment history, credit profiles, geographic concentrations, credit enhancement, seasoning, and other pertinent factors.

### Interest Rate Risk

Interest rate risk is highly sensitive to many factors, including governmental, monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. We are subject to interest rate risk in connection with our investments and our related debt obligations, which are generally repurchase agreements, warehouse facilities and securitization/re-securitization vehicles. Our repurchase agreements and warehouse facilities may be of limited duration that is periodically refinanced at current market rates. We intend to mitigate this risk through utilization of derivative contracts, primarily interest rate swap agreements, swaptions, futures and mortgage options.

### Interest Rate Effects on Net Interest Income

Our operating results depend, in large part, on differences between the income from our investments and our borrowing costs. Most of our warehouse facilities and repurchase agreements provide financing based on a floating rate of interest calculated on a fixed spread over LIBOR. The fixed spread varies depending on the type of underlying asset which collateralizes the financing. Accordingly, the portion of our portfolio which consists of floating interest rate assets will be match-funded utilizing our expected sources of short-term financing, while our fixed interest rate assets will not be match-funded. During periods of rising interest rates, the borrowing costs associated with our investments tend to increase while the income earned on our fixed interest rate investments may remain substantially unchanged. This will result in a narrowing of the net interest spread between the related assets and borrowings and may even result in losses. Further, during this portion of the interest rate and credit cycles, defaults could increase and result in credit losses to us, which could adversely affect our liquidity and operating results. Such delinquencies or defaults could also have an adverse effect on the spread between interest-earning assets and interest-bearing liabilities. Hedging techniques are partly based on assumed levels of prepayments of our fixed-rate and hybrid adjustable-rate mortgage loans and RMBS. If prepayments are slower or faster than assumed, the life of the mortgage loans and RMBS will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions.

### Interest Rate Effects on Fair Value

Another component of interest rate risk is the effect changes in interest rates will have on the fair value of the assets we acquire. We face the risk that the fair value of our assets will increase or decrease at different rates than that of our liabilities, including our hedging instruments. We primarily assess our interest rate risk by estimating the duration of our assets and the duration of our liabilities. Duration essentially measures the market price volatility of financial instruments as interest rates change. We generally calculate duration using various financial models and empirical data. Different models and methodologies can produce different duration numbers for the same securities.

It is important to note that the impact of changing interest rates on fair value can change significantly when interest rates change beyond 100 basis points from current levels. Therefore, the volatility in the fair value of our assets could increase significantly when interest rates change beyond 100 basis points. In addition, other factors impact the fair value of our interest rate-sensitive investments and hedging instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, in the event of changes in actual interest rates, the change in the fair value of our assets would likely differ from that shown below and such difference might be material and adverse to our stockholders.

### Interest Rate Cap Risk

We also invest in adjustable-rate mortgage loans and RMBS. These are mortgages or RMBS in which the underlying mortgages are typically subject to periodic and lifetime interest rate caps and floors, which limit the amount by which

the security's interest yield may change during any given period. However, our borrowing costs pursuant to our financing agreements will not be subject to similar restrictions. Therefore, in a period of increasing interest rates, interest rate costs on our borrowings could increase without limitation by caps, while the interest-rate yields on our adjustable-rate mortgage loans and RMBS would effectively be limited. This problem will be magnified to the extent we acquire adjustable-rate RMBS that are not based on mortgages which are fully indexed. In addition, the mortgages or the underlying mortgages in an RMBS may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. This could result in our receipt of less cash income on our adjustable-rate mortgages or RMBS than we need in order to pay the interest cost on our related borrowings. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would harm our financial condition, cash flows and results of operations.

## Interest Rate Mismatch Risk

We fund a substantial portion of our acquisitions of RMBS with borrowings that, after the effect of hedging, have interest rates based on indices and re-pricing terms similar to, but of somewhat shorter maturities than, the interest rate indices and re-pricing terms of the mortgages and RMBS. In most cases the interest rate indices and re-pricing terms of our mortgage assets and our funding sources will not be identical, thereby creating an interest rate mismatch between assets and liabilities. Our cost of funds would likely rise or fall more quickly than would our earnings rate on assets. During periods of changing interest rates, such interest rate mismatches could negatively impact our financial condition, cash flows and results of operations. To mitigate interest rate mismatches, we may utilize the hedging strategies discussed above. Our analysis of risks is based on FIDAC's experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our management may produce results that differ significantly from the estimates and assumptions used in our models and the projected results shown in this Form 10-Q.

Our profitability and the value of our portfolio (including derivatives) may be adversely affected during any period as a result of changing interest rates. The following table quantifies the potential changes in net interest income and portfolio value for our Agency RMBS portfolio should interest rates go up or down 50 and 100 basis points, assuming parallel movements in the yield curves. All changes in income and value are measured as percentage changes from the projected net interest income and portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at September 30, 2014 and various estimates regarding prepayment and all activities are made at each level of rate change. Actual results could differ significantly from these estimates.

	September 30, 2014	
	Projected Percentage Change in Net Interest Income (1)	Projected Percentage Change in Portfolio Value with Effect of Interest Rate Swaps and Other Hedging Transactions (2)
Change in Interest Rate		
-100 Basis Points	(20.90%)	(1.23%)
-50 Basis Points	(13.86%)	(0.84%)
Base Interest Rate	-	-
+50 Basis Points	8.18%	(0.78%)
+100 Basis Points	5.91%	(1.95%)

(1) Change in annual economic net interest income. Includes interest expense on interest rate swaps.

(2) Projected Percentage Change in Portfolio Value is based on instantaneous moves in interest rates.

## Prepayment Risk

As we receive prepayments of principal on these investments, premiums and discounts on such investments will be amortized or accreted into interest income. In general, an increase in prepayment rates will accelerate the amortization of purchase premiums, thereby reducing the interest income earned on the investments. Conversely, discounts on such

investments are accelerated and accreted into interest income increasing interest income.

#### Extension Risk

Our Manager computes the projected weighted-average life of our investments based on assumptions regarding the rate at which the borrowers will prepay the underlying mortgages. In general, when fixed-rate or hybrid adjustable-rate mortgage loans or RMBS are acquired via borrowings, we may, but are not required to, enter into an interest rate swap agreement or other hedging instrument that effectively fixes our borrowing costs for a period close to the anticipated average life of the fixed-rate portion of the related assets. This strategy is designed to protect us from rising interest rates as the borrowing costs are effectively fixed for the duration of the fixed-rate portion of the related assets. However, if prepayment rates decrease in a rising interest rate environment, the life of the fixed-rate portion of the related assets could extend beyond the term of the swap agreement or other hedging instrument. This could have a negative impact on our results from operations, as borrowing costs would no longer be fixed after the end of the hedging instrument while the income earned on the fixed and hybrid adjustable-rate assets would remain fixed. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur losses.

### Basis Risk

We seek to limit our interest rate risk by hedging portions of our portfolio through interest rate swaps and other types of hedging instruments. Interest rate swaps are generally tied to underlying Treasury benchmark interest rates. Basis risk relates to the risk of the spread between our RMBS and underlying hedges widening. Such a widening may cause a decline in the fair value of our RMBS that is greater than the increase in fair value of our hedges resulting in a net decline in book value. The widening of mortgage-backed securities yields and Treasury benchmark interest rates may result from a variety of factors such as anticipated or actual monetary policy actions or other market factors.

### Market Risk

#### Market Value Risk

Our available-for-sale securities are reflected at their estimated fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income if no OTTI has been recognized in earnings. The estimated fair value of these securities fluctuates primarily due to changes in interest rates, prepayment speeds, market liquidity, credit quality, and other factors. Generally, in a rising interest rate environment, the estimated fair value of these securities would be expected to decrease; conversely, in a decreasing interest rate environment, the estimated fair value of these securities would be expected to increase. As market volatility increases or liquidity decreases, the fair value of our investments may be adversely impacted.

#### Real Estate Market Risk

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

### Risk Management

To the extent consistent with maintaining our REIT status, we seek to manage risk exposure to protect our portfolio of residential mortgage loans, RMBS, and other assets and related debt against the effects of major interest rate changes. We generally seek to manage risk by:

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

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

- using derivatives, financial futures, swaps, options, caps, floors and forward sales to adjust the interest rate sensitivity of our investments and our borrowings;

- using securitization financing to lower average cost of funds relative to short-term financing vehicles further allowing us to receive the benefit of attractive terms for an extended period of time in contrast to short term financing and maturity dates of the investments not included in the securitization; and

actively managing, on an aggregate basis, the interest rate indices, interest rate adjustment periods, and gross reset margins of our investments and the interest rate indices and adjustment periods of our financings.

Our efforts to manage our assets and liabilities are concerned with the timing and magnitude of the re-pricing of assets and liabilities. We attempt to control risks associated with interest rate movements. Methods for evaluating interest rate risk include an analysis of our interest rate sensitivity “gap,” which is the difference between interest-earning assets and interest-bearing liabilities maturing or re-pricing within a given time period. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities. A gap is considered negative when the amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in overall market rates or conditions, changes in interest rates may affect net interest income positively or negatively even if an institution were perfectly matched in each maturity category.

The following table sets forth the estimated maturity or re-pricing of our interest-earning assets and interest-bearing liabilities at September 30, 2014. The amounts of assets and liabilities shown within a particular period were determined in accordance with the contractual terms of the assets and liabilities, except adjustable-rate loans, and securities are included in the period in which their interest rates are first scheduled to adjust and not in the period in which they mature and includes the effect of the interest rate swaps. The interest rate sensitivity of our assets and liabilities in the table could vary substantially based on actual prepayments.

September 30, 2014

(dollars in thousands)

	Within 3 Months	3-12 Months	1 Year to 3 Years	Greater than 3 Years	Total
Rate sensitive assets	\$ 1,435,030	\$ 1,792,010	\$ 831,528	\$ 20,763,970	\$ 24,822,538
Cash equivalents	241,643	-	-	-	241,643
Total rate sensitive assets	1,676,673	1,792,010	831,528	20,763,970	25,064,181
Rate sensitive liabilities	8,484,669	1,331,095	20,895	8,473	9,845,133
Interest rate sensitivity gap	\$ (6,807,996)	\$ 460,915	\$ 810,633	\$ 20,755,497	\$ 15,219,048
Cumulative rate sensitivity gap	\$ (6,807,996)	\$ (6,347,081)	\$ (5,536,448)	\$ 15,219,049	
Cumulative interest rate sensitivity gap as a percentage of total rate sensitive assets	-27	% -25	% -22	% 61	%



Our analysis of risks is based on our manager's experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our manager may produce results that differ significantly from the estimates and assumptions used in our models and the projected results shown in the above tables and in this Form 10-Q. These analyses contain certain forward-looking statements and are subject to the safe harbor statement set forth under the heading, "Special Note Regarding Forward-Looking Statements."

#### ITEM 4. Controls and Procedures

##### Changes in Internal Controls

In our Annual Report on Form 10-K for the year ended December 31, 2013, we disclosed that management had identified material weaknesses in our internal controls over financial reporting. We did not design and maintain adequate procedures or effective review and approval controls, including the review of journal entries and reconciliations, over routine processes. We did not design and maintain adequate review and approval controls over significant estimates and their related disclosure process to prevent or detect a material misstatement and we identified an overreliance on spreadsheets consisting of manual inputs and complex calculations used to record transactions and estimates supporting the financial statement amounts and disclosures.

Based upon the substantial work described in our Form 10-K for the year ended December 31, 2013 and our subsequent quarterly reports on Form 10-Q, and the procedures performed through the filing of this Form 10-Q, we have concluded that the consolidated financial statements for the periods covered by and included in this Form 10-Q are prepared in accordance with GAAP and fairly present in all material respects, our financial position, results of operation and cash flows for each of the periods presented herein.

Our Chief Executive Officer and Chief Financial Officer determined that the aforementioned material weaknesses in our internal controls over financial reporting were not fully remediated and that our disclosure controls and procedures were not effective as of September 30, 2014.

To address the material weaknesses regarding review and approval controls over routine processes, the Company has significantly enhanced its review and approval procedures, including the evidence of review. The Company also implemented an electronic document management program to maintain an audit trail of review procedures and approvals.

To address the material weaknesses regarding review and approval controls over significant estimates, the Company has significantly enhanced its review of the fair values reported by the Company. As discussed in Footnote 5, the Company has a robust and independent pricing process to ensure fair values are accurately and completely recorded and appropriate levels of review, analysis and comparison exist before utilizing fair values for financial reporting purposes. The Company continues to implement new systems to reduce its reliance on spreadsheets. The Company has enhanced its review procedures on the spreadsheets it uses for financial reporting, but expects many of the spreadsheets will not be necessary in 2015 when new systems are in place and operational for financial reporting purposes.

Other than the changes discussed above, there have been no changes in our “internal control over financial reporting” (as defined in Rule 13a-15 (f) under the Securities Exchange Act of 1934, as amended) that occurred during the period covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. Other Information

### Item 1. Legal Proceedings

After the issuance of the interim financial statements for the third quarter of 2011, the Audit Committee of our Board of Directors initiated an internal investigation, with the assistance of outside counsel and financial advisors engaged by outside counsel, regarding the facts and circumstances relating to our accounting for Non-Agency RMBS and the restatement of our financial statements.

Our Board of Directors has received three derivative demand letters alleging, among other things, that the directors and our officers, as well as our Manager, FIDAC, breached their fiduciary duties to us by failing to institute adequate internal controls and failing to ensure that we made accurate financial disclosures. These letters request, among other things, that the Board of Directors take action to investigate and remedy the alleged breaches of fiduciary duty. The Audit Committee has reached an understanding with FIDAC that resolves the issues raised in the derivative demand letters. The Audit Committee is also pursuing additional remedies against other parties regarding the facts and circumstances relating to our accounting for Non-Agency RMBS and the restatement of our financial statements. These and other potential actions that may be filed against us, whether with or without merit, may divert the attention of management from our business, harm our reputation and otherwise may have a material adverse effect on our business, financial condition, results of operations and cash flows.

Item 1A. Risk Factors

Under “Part I — Item 1A — Risk Factors” of our Form 10-K for the year ended December 31, 2013, we set forth risk factors related to (i) risks associated with adverse developments in the mortgage finance and credit markets, (ii) risks associated with our management and relationship with our Manager, (iii) risks related to our business, (iv) risks related to our investments, (v) regulatory and legal risks, (vi) risks related to our common stock (vii) tax risks, and (viii) risks associated with the late filings and related matters. You should carefully consider the risk factors set forth in our Form 10-K for the year ended December 31, 2013. As of the date hereof, there have been no material changes to the risk factors set forth in our Form 10-K for the year ended December 31, 2013.

Item 6. Exhibits

Exhibits:

The exhibits required by this item are set forth on the Exhibit Index attached hereto

EXHIBIT INDEX

Exhibit Number	Description
3.1	Articles of Amendment and Restatement of Chimera Investment Corporation (filed as Exhibit 3.1 to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No. 333-145525) filed on September 27, 2007 and incorporated herein by reference).
3.2	Articles of Amendment of Chimera Investment Corporation (filed as Exhibit 3.1 to the Company's Report on Form 8-K filed on May 28, 2009 and incorporated herein by reference)
3.3	Articles of Amendment of Chimera Investment Corporation (filed as Exhibit 3.1 to the Company's Report on Form 8-K filed on November 5, 2010 and incorporated herein by reference).
3.4	Amended and Restated Bylaws of Chimera Investment Corporation (filed as Exhibit 3.2 to the Company's Report on Form 8-K filed on December 19, 2011 and incorporated herein by reference).
4.1	Specimen Common Stock Certificate of Chimera Investment Corporation (filed as Exhibit 4.1 to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No. 333-145525) filed on September 27, 2007 and incorporated herein by reference).
31.1	Certification of Matthew Lambiase, Chief Executive Officer and President of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Rob Colligan, Chief Financial Officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Matthew Lambiase, Chief Executive Officer and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Rob Colligan, Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 101.INS XBRL	Instance Document **
Exhibit 101.SCH XBRL	Taxonomy Extension Schema Document **
Exhibit 101.CAL XBRL	Taxonomy Extension Calculation Linkbase Document **
Exhibit 101.DEF XBRL	Additional Taxonomy Extension Definition Linkbase Document Created**
Exhibit 101.LAB XBRL	Taxonomy Extension Label Linkbase Document **
Exhibit 101.PRE XBRL	Taxonomy Extension Presentation Linkbase Document **

\*\* Submitted electronically herewith. Attached as Exhibit 10.1 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Financial Condition as of September 30, 2014 (Unaudited) and December 31, 2013 (derived from the audited consolidated financial statements); (ii) Consolidated Statements of Operations and Comprehensive Income for the quarters and nine months ended September 30, 2014 and 2013; (iii) Consolidated Statement of Stockholders' Equity (Deficit) for the nine months ended September 30, 2014 and 2013; (iv) Consolidated Statements of Cash Flows for the nine months ended

September 30, 2014 and 2013; and (v) Notes to Consolidated Financial Statements.

75

---

SIGNATURES

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

CHIMERA INVESTMENT CORPORATION

By: /s/ Matthew Lambiase  
Matthew Lambiase  
(Chief Executive Officer and President  
and duly authorized officer of the registrant)

Date: November 10, 2014

By: /s/ Rob Colligan  
Rob Colligan  
(Chief Financial Officer  
and principal financial officer of the  
registrant)

Date: November 10, 2014

S-1