Invesco Mortgage Capital Inc.
Form 10-K
February 20, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K
(Mark One)
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from to
Commission file number 001-34385
(Exact name of registrant as specified in its charter)

Maryland	26-2749336
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1555 Peachtree Street, N.E., Suite 1800 Atlanta, Georgia	30309
(Address of principal executive offices)	(Zip Code)

(404) 892-0896
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.01 per share	New York Stock Exchange
7.75% Series A Cumulative Redeemable Preferred Stock	New York Stock Exchange
7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock	New York Stock Exchange
7.50% Fixed-to-Floating Series C Cumulative Redeemable Preferred Stock	New York Stock Exchange

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

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No ¨
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ¨ No ý
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ý No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer	ý	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨
		Emerging growth company	o

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

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

The aggregate market value of the registrant’s common stock held by non-affiliates was $1,773,932,599 based on the closing sales price on the New York Stock Exchange on June 30, 2018. As of February 19, 2019, there were 127,684,996 outstanding shares of common stock of Invesco Mortgage Capital Inc.

Documents Incorporated by Reference

Part III of this Form 10-K incorporates by reference certain information (solely to the extent explicitly indicated) from the registrant’s proxy statement for the 2019 Annual Meeting of Stockholders to be filed pursuant to Regulation 14A.

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Forward-Looking Statements

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

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

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- changes in governmental regulations, zoning, insurance, eminent domain and tax laws and rates, and similar matters and our ability to respond to such changes;
- our ability to maintain our qualification as a real estate investment trust for U.S. federal income tax purposes;
- our ability to maintain our exception from the definition of "investment company" under the Investment Company Act of 1940, as amended (the "1940 Act");
- availability of investment opportunities in mortgage-related, real estate-related and other securities;
- availability of U.S. Government Agency guarantees with regard to payments of principal and interest on securities;
- the market price and trading volume of our capital stock;
- availability of qualified personnel of our Manager;
- the relationship with our Manager;
- estimates relating to taxable income and our ability to continue to pay dividends to our stockholders in the future;
- estimates relating to fair value of our target assets and loan loss reserves;
- our understanding of our competition;
- changes to generally accepted accounting principles in the United States of America ("U.S. GAAP");
- the adequacy of our disclosure controls and procedures and internal controls over financial reporting; and
- market trends in our industry, interest rates, real estate values, the debt securities markets or the general economy.

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

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PART I

Item 1. Business.

Our Company

Invesco Mortgage Capital Inc. (the "Company") is a Maryland corporation primarily focused on investing in, financing, and managing residential and commercial mortgage-backed securities (“MBS”) and other mortgage related assets. Our objective is to provide attractive risk-adjusted returns to our stockholders, primarily through dividends and secondarily through capital appreciation. To achieve this objective, we primarily invest in the following:

- Residential mortgage-backed securities (“RMBS”) that are guaranteed by a U.S. government agency such as the Government National Mortgage Association (“Ginnie Mae”) or a federally chartered corporation such as the Federal National Mortgage Association (“Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac”) (collectively “Agency RMBS”);
- Commercial mortgage-backed securities (“CMBS”) that are guaranteed by a U.S. government agency such as Ginnie Mae or a federally chartered corporation such as Fannie Mae or Freddie Mac (collectively “Agency CMBS”);
- RMBS that are not guaranteed by a U.S. government agency or a federally chartered corporation (“non-Agency RMBS”);
- CMBS that are not guaranteed by a U.S. government agency or a federally chartered corporation (“non-Agency CMBS”);
- Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises (“GSE CRT”);
- Residential and commercial mortgage loans; and
- Other real estate-related financing arrangements.

We conduct our business through our wholly-owned subsidiary, IAS Operating Partnership L.P. (the “Operating Partnership”). We are externally managed and advised by Invesco Advisers, Inc. (our "Manager"), an indirect wholly-owned subsidiary of Invesco Ltd. ("Invesco").

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

Capital Activities

On November 30, 2018, we redeemed all of the Operating Partnership Units ("OP Units") held by a wholly-owned Invesco subsidiary for $21.8 million. The OP Units represented approximately 1.3% of the Operating Partnership prior to the redemption. We also repurchased 75,100 shares of common stock owned by our Manager for $1.1 million through our share repurchase program. The redemption price for the OP Units and common stock was equal to the market value of an equivalent number of shares of our registered common stock. As of December 31, 2018, we had authority to purchase 18,163,982 shares of our common stock through our share repurchase program.

In December 2017, we entered into an equity distribution agreement with a placement agent under which we may sell up to 17,000,000 shares of our common stock from time to time in at-the-market or privately negotiated transactions. These shares are registered with the SEC under our automatic shelf registration statement (as amended and/or supplemented). As of December 31, 2018, we have not sold any shares of common stock under the equity distribution agreement.

Our Manager

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

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Our Competitive Advantages

We believe that our competitive advantages include the following:

Significant Experience of Our Senior Management and Our Manager

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

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

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

Extensive Strategic Relationships and Experience of our Manager and its Affiliates

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

Disciplined Investment Approach

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

Investment Strategy

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

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Agency RMBS

Agency RMBS are residential mortgage-backed securities issued by a U.S. government agency such as Ginnie Mae, or a federally chartered corporation such as Fannie Mae or Freddie Mac (Government Sponsored Enterprises or "GSEs") that are secured by a collection of mortgages. Payments of principal and interest on Agency RMBS, not the market value of the securities themselves, are guaranteed by the issuer. Agency RMBS differ from other forms of traditional debt securities, which normally provide for periodic payments of interest in fixed amounts with principal payments at maturity or on specified call dates. Instead, Agency RMBS provide for monthly payments of both principal and interest. In effect, these payments are a “pass-through” of scheduled and unscheduled principal payments and the monthly interest payments made by the individual borrowers on the mortgage loans, net of any fees paid to the servicers, guarantors or other related parties of the securities.

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

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

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

Mortgage pass-through certificates, collateralized mortgage obligations (“CMOs”), Freddie Mac Gold Certificates, Fannie Mae Certificates and Ginnie Mae Certificates are types of Agency RMBS that are collateralized by either fixed-rate mortgage loans (“FRMs”), adjustable-rate mortgage loans (“ARMs”), or hybrid ARMs. FRMs have an interest rate that is fixed for the term of the loan and do not adjust. The interest rates on ARMs generally adjust annually (although some may adjust more frequently) to an increment over a specified interest rate index. Hybrid ARMs have interest rates that are fixed for a specified period of time (typically three, five, seven or ten years) and, thereafter, adjust to an increment over a specified interest rate index. ARMs and hybrid ARMs generally have periodic and lifetime constraints on how much the loan interest rate can change on any predetermined interest rate reset date.

Our allocation of our Agency RMBS collateralized by FRMs, ARMs or hybrid ARMs will depend on various factors including, but not limited to, relative value, expected future prepayment trends, supply and demand, costs of hedging, costs of financing, expected future interest rate volatility and the overall shape of the U.S. Treasury and interest rate swap yield curves. We take these factors into account when we make investments.

Agency CMBS

Agency CMBS are structured pass-through certificates representing interests in pools of commercial loans that are secured by commercial property and issued by a U.S. government agency or federally chartered corporation. Types of Agency CMBS include Fannie Mae DUS (Delegated Underwriting and Servicing), Freddie Mac Multifamily Mortgage Participation Certificates, Ginnie Mae project loan pools, and/or CMOs structured from such collateral. The U.S. government agency or federally chartered corporation sources these loans from a network of approved multi-family sellers/servicers and guarantees the timely payment of interest and principal on these investments. Unlike single family residential mortgages in which the borrower, generally, can prepay at any time, commercial mortgages frequently limit the ability of the borrower to prepay, thereby providing a certain level of prepayment protection. Common restrictions include yield maintenance (a prepayment premium that allows investors to attain the same yield as if the borrower made all scheduled interest payments up until the maturity date) and prepayment penalties.

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Non-Agency CMBS
Non-Agency CMBS are commercial mortgage-backed securities that are not issued or guaranteed by a U.S. government agency or federally chartered corporation. Like Agency CMBS, non-Agency CMBS are securities backed by obligations (including certificates of participation in obligations) that are principally secured by commercial mortgages on real property or interests therein having a multifamily or commercial use, such as regional malls, retail space, office buildings, industrial or warehouse properties, hotels, apartments, nursing homes and senior living facilities.

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

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

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

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

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

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

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

Government-Sponsored Enterprises Credit Risk Transfer Securities
GSE CRTs are unsecured general obligations of the GSEs that are structured to provide credit protection to the issuer with respect to defaults and other credit events within pools of residential mortgage loans that collateralize MBS

issued and guaranteed by the GSEs. This credit protection is achieved by allowing the GSEs to reduce the outstanding class principal

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balance of the securities as designated credit events on the loans arise. The GSEs make monthly payments of accrued interest and periodic payments of principal to the holders of the securities. To date, all GSE CRTs have paid a floating interest rate benchmarked to one-month LIBOR.

Commercial Mortgage Loans

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

Mezzanine Loans

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

Loan Participation Interest

We have an investment in a loan participation interest in a secured loan to a non-bank servicer that is collateralized by mortgage servicing rights associated with Fannie Mae, Freddie Mac, and Ginnie Mae loans. Mortgage servicing rights represent the right to perform and control the servicing of mortgage loans in exchange for a fee. The loan has a two year term subject to a one year extension at the borrower's option and pays a floating interest rate benchmarked to one-month LIBOR. Our commitment under the agreement may be funded over the term of the loan based upon the financing needs of the borrower.

Unconsolidated Ventures

We have investments in unconsolidated ventures. In circumstances where we have a non-controlling interest but we are deemed to be able to exert significant influence over the affairs of the enterprise, we utilize the equity method of accounting. Under the equity method of accounting, the initial investment is increased each period for additional capital contributions and a proportionate share of the entity's earnings and decreased for cash distributions and a proportionate share of the entity's losses.

Financing Strategy

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

Repurchase Agreements

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

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Secured Loans

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

Leverage

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

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

Risk Management Strategy

Market Risk Management

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

Interest Rate Risk

We engage in a variety of interest rate management techniques that seek to mitigate the influence of interest rate changes on the costs of liabilities and help us achieve our risk management objectives. Specifically, we seek to hedge our exposure to potential interest rate mismatches between the interest we earn on our investments and our borrowing costs caused by fluctuations in short-term interest rates. We may utilize various derivative financial instruments including puts and calls on securities or indices of securities, futures, interest rate swaps and swaptions, interest rate caps, interest rate floors, exchange-traded derivatives, U.S. Treasury securities and options on U.S. Treasury securities to hedge all or a portion of the interest rate risk associated with the financing of our investment portfolio.

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Spread Risk

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

Credit Risk

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

Liquidity Risk

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

Foreign Exchange Rate Risk

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

Investment Guidelines

Our board of directors has adopted the following investment guidelines:

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

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

Investment Committee

Our investment committee is comprised of certain of our officers and certain of our Manager’s investment professionals. The investment committee periodically reviews our investment portfolio for risk characteristics, investment performance, liquidity, portfolio composition, leverage and other applicable items. It also reviews its compliance with our investment policies and procedures, including our investment guidelines, and our Manager provides our board of directors an investment performance report at the end of each quarter in conjunction with its review of our quarterly results.

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Investment Process
Our Manager's investment team has a strong focus on asset selection and on the relative value of various sectors within the mortgage market. Our Manager utilizes this expertise to build a diversified portfolio. Our Manager incorporates its views on the economic environment and the outlook for the mortgage market, including relative valuation, supply and demand trends, the level of interest rates, the shape of the yield curve, prepayment rates, financing and liquidity, housing prices, delinquencies, default rates and loss severity rates of various collateral types.
Our investment process includes sourcing and screening investment opportunities, assessing investment suitability, conducting interest rate and prepayment analysis, evaluating cash flow and collateral performance, reviewing legal structure and servicer and originator information and investment structuring, as appropriate, to ensure an attractive return commensurate with the risk we are bearing. Upon identification of an investment opportunity, the investment will be screened and monitored by our Manager to determine its impact on maintaining our REIT qualification and our exemption from registration under the 1940 Act. We make investments in sectors where our Manager has strong core competencies and where we believe market risk and expected performance can be reasonably quantified.
Our Manager evaluates each of our investment opportunities based on its expected risk-adjusted return relative to the returns available from other, comparable investments. In addition, we evaluate new opportunities based on their relative expected returns compared to assets held in our portfolio. The terms of any leverage available to us for use in funding an investment purchase are also taken into consideration, as are any risks posed by illiquidity or correlations with other assets in the portfolio. Our Manager also develops a macro outlook with respect to each target asset class by examining factors in the broader economy such as gross domestic product, interest rates, unemployment rates and availability of credit, among other factors. Our Manager analyzes fundamental trends in the relevant target asset class sector to adjust or maintain its outlook for that particular target asset class. These macro decisions guide our Manager's assumptions regarding model inputs and portfolio allocations among target assets. Additionally, our Manager conducts extensive diligence with respect to each target asset class by, among other things, examining and monitoring the capabilities and financial wherewithal of the parties responsible for the origination, administration and servicing of relevant target assets.
Competition
Our net income depends, in large part, on our ability to acquire assets at favorable spreads over our borrowing costs. In acquiring our investments, we compete with other REITs, specialty finance companies, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, financial institutions, governmental bodies and other entities. In addition, there are numerous REITs with similar asset acquisition objectives. These other REITs increase competition for the available supply of mortgage assets suitable for purchase. Many of our competitors are significantly larger than we are, have access to greater capital and other resources and may have other advantages over us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than we can. Market conditions may attract more competitors, which may increase the competition for sources of financing. An increase in the competition for sources of financing could adversely affect the availability and cost of financing.
We have access to our Manager's professionals and their industry expertise, which we believe provides us with a competitive advantage. These professionals help us assess investment risks and determine appropriate pricing for certain potential investments. These relationships enable us to compete more effectively for attractive investment opportunities. Despite certain competitive advantages, we may not be able to achieve our business goals or expectations due to the competitive risks that we face. For additional information concerning these competitive risks, refer to "Risk Factors — Risks Related to Our Investments". We operate in a highly competitive market for investment opportunities. Competition may limit our ability to acquire desirable investments in our target assets, and could also affect the pricing of these securities.
Our Corporate Information
Our principal executive offices are located at 1555 Peachtree Street, N.E., Suite 1800, Atlanta, Georgia 30309. Our telephone number is (404) 892-0896. We file current and periodic reports, proxy statements and other information with the SEC. The SEC maintains a website that contains reports, proxy and other information at www.sec.gov. We

make available free of charge on our corporate website, www.invescomortgagecapital.com, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information on our website is not intended to form a part of or be incorporated by reference into this Report.

Item 1A. Risk Factors.

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

Risks Related to Our Investments

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

Our results of operations are materially affected by conditions in the mortgage market, the residential and commercial real estate markets, the financial markets and the economy generally. Concerns about the mortgage market and real estate market, as well as inflation, energy costs, geopolitical issues and the availability and cost of credit, contribute to market volatility. Any deterioration of the real estate market may cause us to experience losses related to our assets and to sell assets at a loss.

Declines in the market values of our MBS and GSE CRTs may adversely affect our results of operations and credit availability, which may reduce earnings and, in turn, cash available for distribution to our stockholders. In addition, a decline in market values of our MBS and GSE CRTs will reduce our book value per diluted common share.

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

We bear the risk of being unable to dispose of our assets at advantageous times or in a timely manner because mortgage-related assets generally experience periods of illiquidity. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited, which may cause us to incur losses. In addition, many of the assets that comprise our investment portfolio are not publicly traded. These securities may be less liquid than publicly-traded securities. The illiquidity of our investments may make it difficult for us to sell such investments if the need or desire arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded our investments. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited, which could adversely affect our results of operations and financial condition.

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

While we diversify and intend to continue to diversify our portfolio of investments, we are not required to observe specific diversification criteria, except as may be set forth in the investment guidelines adopted by our board of directors. Therefore, our investments in our target assets may at times be concentrated in certain property types that are subject to higher risk of foreclosure, or secured by properties concentrated in a limited number of geographic locations. For example, as of December 31, 2018, a significant percentage of our non-Agency RMBS, GSE CRTs and non-Agency CMBS was secured by property located in California, as well as New York with respect to our CMBS. Refer to “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Investment Activities - Portfolio Characteristics” for additional information. To the extent that our portfolio is concentrated in any one region or type of security, downturns relating generally to such region or type of security may result in defaults on a number of our investments within a short time period, which may reduce our net income and the value of our capital stock and accordingly reduce our ability to pay dividends to our stockholders.

We may invest in assets with which our stockholders may not agree and/or fail to meet our investment criteria.

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

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

Mortgage-backed securities are secured by mortgage loans (primarily single family residential properties for RMBS and single commercial mortgage loans or a pool of commercial mortgage loans for CMBS). GSE CRTs are unsecured obligations of the GSEs. Our MBS and GSE CRT investments are subject to all the risks of the respective underlying mortgage loans, including risks of defaults, foreclosure timeline extension, fraud, price depreciation and unfavorable modification of loan principal amount, interest rate and amortization of principal.

The ability of a borrower to repay a mortgage loan secured by a residential property is dependent in part upon the income and assets of the borrower. A number of factors over which we have no control may impair a borrower's ability to repay their loans.

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

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

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

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

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

We invest in certain tranches of MBS that are only entitled to a portion of the principal and interest payments made on mortgage loans underlying the securities issued by the trust. In general, losses on a mortgage loan included in a RMBS trust will be borne first by the equity holder of the issuing trust if any, and then by the "first loss" subordinated security holder and then by the "second loss" subordinate holder and so on. For non-Agency CMBS assets, losses on a mortgaged property securing a mortgage loan included in a securitization will typically be borne first by the equity holder of the property, then by a cash reserve fund or letter of credit, if any, then by the holder of a mezzanine loan or B-Note, if any, then by the "first loss" subordinated security holder (generally, the "B-Piece" buyer) and then by the holder of a higher-rated security.

We may acquire securities at every level of such a trust, from the equity position to the most senior tranche. In the event of default and the exhaustion of any classes of securities junior to those which we acquire, our securities will suffer losses as well. In addition, if we overvalue the underlying mortgage portfolio, or if the values subsequently decline and, as a result, less collateral is available to satisfy interest and principal payments due on the related MBS, the securities which we acquire may effectively become the "first loss" position ahead of the more senior securities, which may result in significant losses. The prices of lower credit quality securities are generally less sensitive to interest rate changes than more highly rated securities, but more sensitive to adverse economic downturns or individual issuer developments. A projection of an economic downturn could cause a decline in the value of lower credit quality securities because the ability of obligors of mortgages underlying MBS to make principal and interest payments may be impaired. In such event, existing credit support in the securitization structure may be insufficient to protect us against loss of our principal on these securities.

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

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

We invest in RMBS, CMBS, GSE CRTs, and mortgage loans and other financing arrangements that are subject to risks related to interest rate fluctuations. Fluctuations in short- or long-term interest rates could have adverse effects on our operations and financial condition, which may negatively affect cash available for distribution to our stockholders. Fluctuations in interest rates could impact us as follows:

- If long-term rates increased significantly, the market value of our fixed rate investments in our target assets would decline, and the duration and weighted average life of the investments may increase. We could realize a loss if the securities were sold. Further, declines in market value may reduce our book value per diluted common share and ultimately reduce earnings or result in losses to us.
- An increase in short-term interest rates would increase the amount of interest owed on the repurchase agreements we enter into to finance the purchase of our investments.
- If short-term interest rates rise disproportionately relative to longer-term interest rates (a flattening of the yield curve), our borrowing costs may increase more rapidly than the interest income earned on our assets. Because we expect our investments, on average, generally will bear interest based on longer-term rates than our borrowings, a flattening of the yield curve would tend to decrease our net income. Additionally, to the extent cash flows from investments that return scheduled and unscheduled principal are reinvested, the spread between the yields on the new investments and available borrowing rates may decline, which would likely decrease our net income.
- If short-term interest rates exceed longer-term interest rates (a yield curve inversion), our borrowing costs may exceed our interest income and we could incur operating losses.
- If interest rates fall, we may recognize losses on our derivative financial instruments that are not offset by gains on our assets, which may adversely affect our liquidity and financial position.

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

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

Changes in the method under which LIBOR is determined or the discontinuance of LIBOR may adversely affect the amount of interest payable or interest receivable on certain portfolio investments, repurchase agreements and interest rate swaps as well as our dividends on our Series B preferred stock and Series C preferred stock. These changes may also impact the market liquidity and market value of certain portfolio investments, interest rate swaps and our Series B and Series C preferred stock.

LIBOR, as well as other interest rate, equity, foreign exchange rate and other types of indices which are deemed to be "benchmarks," are the subject of ongoing international, national and other regulatory guidance and proposals for reform. Some of these reforms are already effective while others are still to be implemented. These reforms may cause LIBOR to perform differently than in the past, to be phased out, or have other consequences which cannot be fully anticipated.

These proposals for reform or increased regulatory scrutiny of benchmarks could also increase the costs and risks of administering or otherwise participating in the setting of LIBOR and complying with any such regulations. Such factors may have the effect of discouraging market participants from continuing to administer or contribute to LIBOR, trigger changes in the rules or methodologies used in the administration or determination of LIBOR or lead to the phase out of LIBOR.

On July 27, 2017, the Chief Executive of the U.K. Financial Conduct Authority (the "FCA"), which regulates LIBOR, announced that the FCA will no longer persuade or compel banks to submit rates for the calculation of the LIBOR benchmark after 2021. This announcement indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021, and it appears likely that LIBOR will be phased out or the methodology for determining LIBOR will be modified by 2021. The Alternative Reference Rates Committee ("ARRC") has proposed that the Secured Overnight Financing Rate ("SOFR") is the rate that represents best practice as the alternative to USD-LIBOR for use in derivatives and other financial contracts that are currently indexed to USD-LIBOR. ARRC has proposed a paced market transition plan to SOFR from USD-

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LIBOR and organizations are currently working on industry wide and company specific transition plans as it relates to derivatives and cash markets exposed to USD-LIBOR.

The Company has material contracts that are indexed to USD-LIBOR and is monitoring this activity and evaluating the related risks. However, it is not possible to predict the effect of any of these developments and any future initiatives to regulate, reform or change the manner of administration of LIBOR could result in adverse consequences to the rate of interest payable and receivable on, market value of and market liquidity for LIBOR-based financial instruments.

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

We operate in a highly competitive market for investment opportunities. Our profitability depends, in large part, on our ability to acquire our target assets at attractive prices. We compete with a variety of institutional investors, including other REITs and many of our competitors are substantially larger and may have considerably greater financial, technical, marketing and other resources than we do. Some competitors may have a lower cost of funds and access to funding sources that may not be available to us. Many of our competitors are not subject to the operating constraints associated with REIT tax compliance or maintenance of an exemption from the 1940 Act. Furthermore, competition for investments in our target assets may lead to the price of such assets increasing, which may further limit our ability to generate desired returns. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. Also, as a result of this competition, desirable investments in our target assets may be limited in the future, and we may not be able to take advantage of attractive investment opportunities from time to time, as we can provide no assurance that we will be able to identify and make investments that are consistent with our investment objectives.

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

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

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

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

We and third party loan originators and servicers’ due diligence of potential assets may not reveal all of the liabilities associated with such assets and may not reveal other weaknesses in such assets, which could lead to losses.

Before making an asset acquisition, we will assess the strengths and weaknesses of the originator or issuer of the asset as well as other factors and characteristics that are material to the performance of the asset. In making the assessment and otherwise conducting customary due diligence, we will rely on resources available to us, including third party loan originators and servicers. This process is particularly important with respect to newly formed originators or issuers because there may be little or no information publicly available about these entities and assets. There can be no assurance that our due diligence process will uncover all relevant facts or that any asset acquisition will be successful, which could lead to losses in the value of our portfolio.

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

We depend on a variety of services provided by third-party service providers related to our RMBS. We rely on the mortgage servicers who service the mortgage loans backing our RMBS to, among other things, collect principal and interest payments and administer escrow accounts on the underlying mortgages and perform loss mitigation services. At times, mortgage servicers and other service providers to our RMBS, may not perform in a manner that promotes our interests.

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For example, legislation intended to reduce or prevent foreclosures through, among other things, loan modifications, short sales and other foreclosure alternatives, may reduce the value of mortgage loans underlying our RMBS. Mortgage servicers may be incentivized to pursue such loan modifications, as well as forbearance plans and other actions intended to prevent foreclosure, even if such loan modifications and other actions are not in the best interests of the beneficial owners of the mortgage loans. Similarly, legislation at both the federal and state level delaying the initiation or completion of foreclosure proceedings on specified types of residential mortgage loans or otherwise limiting the ability of mortgage servicers to take actions that may be essential to preserve the value of the mortgage loans may also reduce the value of mortgage loans underlying our RMBS. Any such limitations are likely to cause delayed or reduced collections from mortgagors and generally increase servicing costs and potential foreclosure-related litigation. As a consequence of the foregoing matters, our business, financial condition and results of operations may be adversely affected.

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

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

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

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

We may acquire B-Notes, mortgage loans typically (i) secured by a first mortgage on a single large commercial property or group of related properties, and (ii) subordinated to an A-Note secured by the same first mortgage on the same collateral. As a result, if a borrower defaults, there may not be sufficient funds remaining for B-Note holders after payment to the A-Note holders. Further, B-Notes typically are secured by a single property and reflect the risks associated with significant concentration.

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

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

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

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

If we acquire or foreclose on properties with respect to which we have extended mortgage loans, we may be subject to environmental liabilities arising from such foreclosed properties. Under various U.S. federal, state and local laws, an owner or operator of real property may become liable for the costs of removal of certain hazardous substances released on its property. These laws often impose liability without regard to whether the owner or operator knew of, or was responsible for, the release of such hazardous substances.

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

A decline in the market value of our mortgage-backed securities and credit risk transfer securities may adversely affect our results of operations and financial condition.

All of our mortgage-backed securities and credit risk transfer securities are reported at fair value. Changes in the market values of these assets impact our stockholders’ equity, and declines in market value adversely affect our book value per diluted common share. Moreover, if the decline in value of an available-for-sale security is other than temporary, such decline will reduce our earnings. For a discussion of how we determine when a security is other than temporarily impaired, see Note 2 - “Summary of Significant Accounting Policies” of our consolidated financial statements in Part IV of this Report.

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

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

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

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

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

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

- We may purchase RMBS that have a higher interest rate than the market interest rate at the time. In exchange for this higher interest rate, we may pay a premium over the par value to acquire the security. In accordance with U.S. GAAP, we may amortize this premium over the estimated term of the RMBS. If the RMBS is prepaid in whole or in part prior to its maturity date, however, we may be required to expense the premium that was prepaid at the time of the prepayment.
- A substantial portion of our adjustable-rate RMBS may bear interest rates that are lower than their fully indexed rates, which are equivalent to the applicable index rate plus a margin. If an adjustable-rate RMBS is prepaid prior to or soon after the time of adjustment to a fully-indexed rate, we will have held that RMBS while it was least profitable and lost the opportunity to receive interest at the fully indexed rate over the remainder of its expected life.
- If we are unable to acquire new RMBS at similar yields to the prepaid RMBS, our financial condition, results of operations and cash flow would suffer. Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by conditions in the housing and financial markets, general economic conditions and the relative interest rates on FRMs and ARMs.

While we seek to minimize prepayment risk to the extent practical, in selecting investments we must balance prepayment risk against other risks and the potential returns of each investment. No strategy can completely insulate us from prepayment risk.

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

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

Risks Related to Financing and Hedging

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

We use leverage to finance our assets through borrowings from repurchase agreements and other secured and unsecured forms of borrowing. The amount of leverage we may deploy for particular assets will depend upon our Manager's assessment of the credit and other risks of those assets and is limited by our debt covenants.

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

- general market conditions;
- the lender's view of the quality of our assets, valuation of our assets and our liquidity;
- the lender's perception of our growth potential;
- regulatory requirements;
- our current and potential future earnings and cash distributions; and

•the market price of the shares of our capital stock.

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

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

We depend on repurchase agreement financing to acquire our target assets and our inability to access this funding on acceptable terms could have a material adverse effect on our results of operations, financial condition and business.

We use repurchase agreement financing as a strategy to increase the return on our assets. However, we may not be able to achieve our desired leverage ratio for a number of reasons, including if the following events occur:

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

Our ability to fund our target assets may be impacted by our ability to secure repurchase agreement financing on acceptable terms. We can provide no assurance that lenders will be willing or able to provide us with sufficient financing. In addition, because repurchase agreements are short-term commitments of capital, lenders may respond to market conditions making it more difficult for us to secure continued financing. During certain periods of the credit cycle, lenders may curtail their willingness to provide financing. This may require us to liquidate collateral to satisfy funding requirements. In addition, if major market participants were to exit the repurchase agreement financing business, the value of our portfolio could be negatively impacted, thus reducing net stockholder equity, or book value per diluted common share. Furthermore, if many of our current or potential lenders are unwilling or unable to provide us with repurchase agreement financing, we could be forced to sell our assets at an inopportune time when prices are depressed. In addition, if the regulatory capital requirements imposed on our lenders change, they may be required to significantly increase the cost of the financing that they provide to us. Our lenders also may revise their eligibility requirements for the types of assets they are willing to finance or the terms of such financings, based on, among other factors, the regulatory environment and their management of perceived risk, particularly with respect to assignee liability.

If a counterparty to our repurchase transactions defaults on its obligation to resell the underlying security back to us at the end of the transaction term, if the value of the underlying security has declined as of the end of that term, or if we default on our obligations under the repurchase agreement, we may incur a loss on our repurchase transactions.

When we engage in repurchase transactions, we generally sell securities to lenders (repurchase agreement counterparties) and receive cash from these lenders. The lenders are obligated to resell the same or similar securities back to us at the end of the term of the transaction. Because the cash we receive from the lender when we initially sell the securities to the lender is less than the value of those securities (this difference is the haircut), if the lender defaults on its obligation to resell the same securities back to us we may incur a loss on the transaction equal to the amount of the haircut (assuming there was no change in the value of the securities). As of December 31, 2018, two counterparties held collateral that exceeded the amounts borrowed under the related repurchase agreements by more than $114.3 million, or 5% of our stockholders' equity. Refer to Note 7 - "Borrowings" of our consolidated financial statements included in Part IV, Item 15 of this Report, for additional detail. We may incur a loss on a repurchase transaction if the value of the underlying securities has declined as of the end of the transaction term, as we would have to repurchase the securities for their initial value but would receive securities worth less than that amount. Further, if we default on one of our obligations under a repurchase transaction, the lender can terminate the transaction and cease entering into any other repurchase transactions with us. Some of our repurchase agreements contain cross-default provisions, so that if a default occurs under any one agreement, the lenders under our other agreements could also declare a default. Any losses we incur on our repurchase transactions could adversely affect our earnings and thus our cash available for distribution to our stockholders.

The repurchase agreements, secured loans and other financing arrangements that we use to finance our investments may require us to provide additional collateral and may restrict us from leveraging our assets as fully as desired.
The amount of financing we receive, or may in the future receive, under our repurchase agreements, secured loans and other financing arrangements, is directly related to the lenders' valuation of the assets that secure the outstanding borrowings. Lenders under our repurchase agreements and secured loans typically have the absolute right to reevaluate the market value of the assets that secure outstanding borrowings at any time. If a lender determines in its sole discretion that the value of the assets has decreased, it has the right to initiate a margin call or increase collateral requirements. A margin call or increased collateral requirements would require us to transfer additional assets to such lender without any advance of funds from the lender for

such transfer or to repay a portion of the outstanding borrowings. Any such margin call or increased collateral requirements could have a material adverse effect on our results of operations, financial condition, business, liquidity and ability to pay dividends to our stockholders, and could cause the value of our capital stock to decline. We may be forced to sell assets at significantly depressed prices to meet such margin calls and to maintain adequate liquidity, which could cause us to incur losses. Moreover, to the extent we are forced to sell assets at such time, given market conditions, we may be selling at the same time as others facing similar pressures, which could exacerbate a difficult market environment and which could result in our incurring significantly greater losses on our sale of such assets. In an extreme case of market duress, a market may not even be present for certain of our assets at any price. Such a situation would likely result in a rapid deterioration of our financial condition and possibly necessitate a filing for bankruptcy protection.

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

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

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

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

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

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

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

Hedging may adversely affect our earnings, which could reduce our cash available for distribution to our stockholders.

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

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

- the amount of income that a REIT may earn from hedging transactions (other than hedging transactions that satisfy certain requirements of the Internal Revenue Code or that are done through a taxable REIT subsidiary (“TRS”)) to offset interest rate losses is limited by U.S. federal tax provisions governing REITs;
- the credit quality of the hedging counterparty owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the hedging counterparty owing money in the hedging transaction may default on its obligation to pay.

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

In addition, the enforceability of agreements underlying hedging transactions may depend on compliance with applicable statutory and commodity and other regulatory requirements and, depending on the identity of the counterparty, applicable international requirements. Any actions taken by regulators could constrain our investment strategy and could increase our costs, either of which could materially and adversely impact our results of operations.

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

We have entered into, and may again in the future enter into, derivative contracts that could require us to make cash payments in certain circumstances. Potential payment obligations would be contingent liabilities and may not appear on our balance sheet. Our ability to satisfy these contingent liabilities depends on the liquidity of our assets and our access to capital and cash. The need to fund these contingent liabilities could adversely impact our financial condition.

We may invest in synthetic securities, credit default swaps, and other credit derivatives that reference other real estate securities or indices. These investments may present risks in excess of those resulting from the referenced security or index. These investments are typically a contractual relationship with counterparties and not an acquisition of a referenced security or other asset. In these types of investments, we have no right to directly enforce compliance with the terms of the referenced security or other assets and we have no voting or other consensual rights of ownership with respect to the referenced security or other assets. In the event of insolvency of a counterparty, we will be treated as a general creditor of the counterparty and will have no claim of title with respect to the referenced security.

The markets for these types of investments may not be liquid. Many of these investments incorporate “pay as you go” credit events. For example, the terms of credit default swaps are still evolving and may change significantly, which could make it more difficult to assign such an instrument or determine the “loss” pursuant to the underlying agreement. In a credit default swap, the party wishing to “buy” protection will pay a premium. When interest rates, spreads or the prevailing credit premiums on credit default swaps change, the amount of the termination payment due could change by a substantial amount. In an illiquid market, the determination of this change could be difficult to ascertain and, as a result, we may not achieve the desired benefit of entering into this contractual relationship.

As of December 31, 2018, we have no outstanding credit default swaps. We may over time enter into these types of investments as the market for them evolves and during times when acquiring other real estate loans and securities may be difficult. We may find credit default swaps and other forms of synthetic securities to be a more efficient method of providing exposure to target investments. Our efforts to manage the risk associated with these investments, including counterparty risks, may prove to be insufficient in enabling us to generate the returns anticipated.

It may be uneconomical to "roll" Agency MBS TBA holdings or we may be unable to meet margin calls on TBA contracts, which could negatively affect our financial condition and results of operations.

We may invest in Agency MBS TBA securities as an alternate means of gaining exposure to the Agency MBS market. A TBA contract is an agreement to purchase or sell, for future delivery, an Agency MBS with a specified issuer, term and coupon. A TBA dollar roll is a transaction where two TBA contracts with the same terms but different settlement dates are simultaneously bought and sold. The price difference between those two contracts is commonly referred to as the “drop” and is a reflection of the expected net interest income from an investment in similar Agency mortgage-backed securities, net of an implied financing cost, which would be foregone as a result of settling the contract in the later month rather than in the earlier month. Accordingly, TBA dollar roll income generally represents the economic equivalent of the net interest income earned on the underlying Agency mortgage-backed security less an implied financing cost. Consequently, dollar roll transactions and such forward purchases of Agency securities represent a form of off-balance sheet financing and increase our "at risk" leverage.

The economic return of a TBA dollar roll generally equates to interest income on a generic TBA-eligible security less an implied financing cost, and there may be situations in which the implied financing cost exceeds the interest income, resulting in negative carry on the position. If we roll our TBA dollar roll positions when they have a negative carry, the positions would decrease net income and amounts available for distributions to stockholders.

There may be situations in which we are unable or unwilling to roll our TBA dollar roll positions. The TBA transaction could have a negative carry or otherwise be uneconomical, we may be unable to find counterparties with whom to trade in sufficient volume, or we may be required to collateralize the TBA positions in a way that is uneconomical. Because TBA dollar rolls represent implied financing, an inability or unwillingness to roll has effects similar to any other loss of financing. If we do not roll our TBA positions prior to the settlement date, we would have to take delivery of the underlying securities and settle our obligations for cash. We may not have sufficient funds or alternative financing sources available to settle such obligations. Counterparties may also make margin calls as the value of a generic TBA-eligible security (and therefore the value of the TBA contract) declines. Margin calls on TBA positions or failure to roll TBA positions could have the effects described in the liquidity risks described above.

Risks Related to Our Company

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

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

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

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

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

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

We may in the future organize one or more subsidiaries that seek to rely on other exceptions from being deemed an investment company under the 1940 Act. Any such subsidiary would need to be structured to comply with any guidance that may be issued by the SEC staff.

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There can be no assurance that the laws and regulations governing the 1940 Act status of REITs will not change in a manner that adversely affects our operations or inhibits our ability to pursue our strategies. Any issuance of more specific or different guidance relating to the relevant exemptions and exceptions from the definition of an investment company under the 1940 Act could similarly affect or inhibit our operations. If we, the Operating Partnership or its subsidiaries fail to maintain an exemption from the 1940 Act, we could, among other things, be required to (a) change the investments that we hold or the manner in which we conduct our operations to avoid being required to register as an investment company, (b) effect sales of our assets in a manner that, or at a time when, we would not otherwise choose to do so, or (c) register as an investment company. Any of these events could cause us to incur losses and negatively affect the value of our capital stock, the sustainability of our business model, and our ability to pay dividends, which could have an adverse effect on our business and the market price for our shares of capital stock. In addition, if it were established that we were an unregistered investment company, there would be a risk that we would be subject to monetary penalties or injunctive relief imposed by the SEC.

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

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

More broadly, uncertainties regarding geopolitical developments can produce volatility in global financial markets. In this regard, the United Kingdom (“U.K.”) electorate voted in June 2016 to exit the European Union (“Brexit”), which resulted in increased financial market volatility. Although negotiations between the U.K. and the European Union regarding the U.K.'s planned exit from the European Union on March 29, 2019 are ongoing, it is still uncertain what terms may be agreed upon, if any, and what impact those terms may have on global markets. This may impact foreign exchange rates and create regulatory changes, which could have an adverse effect on our U.K. commercial real estate loan investment.

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

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

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

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We are highly dependent on information systems and systems failures or cyber-attacks could significantly disrupt our business, which may, in turn, negatively affect the market price of our capital stock and our ability to pay dividends.
Our business is highly dependent on third parties' information systems, including our Manager and other service providers. Although our Manager has implemented, and other service providers may implement, various measures to manage risks relating to these types of events, such measures could prove to be inadequate and, if compromised, such systems could become inoperable for extended periods of time, cease to function properly or fail to adequately secure confidential information. We do not control the cyber security plans and systems put in place by our Manager and third party service providers, and such service providers may have limited indemnification obligations to us or our Manager. Any failure or interruption of such systems or cyber-attacks or security breaches could cause delays or other problems in our securities trading activities and financial, accounting and other data processing activities, which could have a material adverse effect on our operating results and negatively affect the market price of our capital stock and our ability to pay dividends to our stockholders. In addition, we also face the risk of operational failure, termination or capacity constraints of any of the third parties with which we do business or that facilitate our business activities, including clearing agents or other financial intermediaries we use to facilitate our securities transactions.
Computer malware, viruses and computer hacking and phishing attacks have become more prevalent and severe in our industry and may occur on our Manager's and other service providers' systems in the future. Cyber attacks and other security threats could originate from a wide variety of sources, including cyber criminals, nation state hackers, hacktivists and other outside parties. There has been an increase in the frequency and sophistication of the cyber and security threats our Manager faces, with attacks ranging from those common to businesses generally to those that are more advanced and persistent, which may target our Manager due to the confidential and sensitive information it holds about its investors, funds, and potential investments. It is difficult to determine what, if any, negative impact may directly result from any specific interruption or cyber-attacks or security breaches of such networks or systems or any failure to maintain the performance, reliability and security of our technical infrastructure. As a result, any computer malware, viruses and computer hacking and phishing attacks may disrupt our normal business operations and expose us to reputational damage and lost business, revenues and profits. Any insurance we maintain against the risk of this type of loss may not be sufficient to cover actual losses or may not apply to circumstances relating to any particular breach.
We may repurchase shares of our common stock or other securities from time to time. Share repurchases may negatively impact our compliance with covenants in our financing agreements and regulatory requirements (including maintaining exclusions from the requirements of the 1940 Act and qualification as a REIT). Any compliance failures associated with share repurchases could have a material negative impact on our business, financial condition and results of operations. Share repurchases also may negatively impact our ability to invest in our target assets in the future.
As of December 31, 2018, 18,163,982 shares of common stock were available under our Board authorized share repurchase program. We may engage in share repurchases from time-to-time through open market purchases, including block purchases or privately negotiated transactions, or pursuant to any trading plan that may adopted in accordance with Rules 10b5-1 and 10b-18 of the Exchange Act. Certain of our financing agreements have financial covenants, including covenants related to maintaining a certain level of stockholders equity, that may be impacted by our share repurchases. In addition, we generally fund share repurchases with interest income or income from the sale of our assets. The sale of assets to fund share repurchases could impact the allocation of our portfolio for purposes of maintaining an exclusion from the requirements of the 1940 Act and could impact our ability to comply with income and asset tests required to qualify as a REIT. The failure to comply with covenants in our financing agreements, to maintain our exemption from the 1940 Act or to qualify as a REIT could have a material negative impact on our business, financial condition and results of operations. In addition, our decision to repurchase shares of our common stock or other securities and reduce our stockholders' equity could adversely affect our competitive position and could negatively impact our ability in the future to invest in assets that have a greater potential return than the repurchase of our common stock.
Our independent registered public accounting firm has advised us that it identified an issue related to an independence requirement contained in the Securities Exchange Act of 1934 regulations regarding auditor independence.

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

The Loan Rule prohibits accounting firms, such as PwC, from having certain financial relationships with their audit clients and affiliated entities. Specifically, the Loan Rule provides, in relevant part, that an accounting firm is not independent if

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it receives a loan from a lender that is a "record or beneficial owner of more than ten percent of the audit client's equity securities." For purposes of the Loan Rule, audit clients include the Company, all of the registered investment companies advised by affiliates of Invesco Ltd., as well as Invesco Ltd. and its other subsidiaries (collectively, the "Invesco Fund Complex") for which PwC also serves as independent auditor. PwC informed us it has relationships with lenders who hold, as record owner, more than ten percent of the shares of certain funds within the Invesco Fund Complex. These relationships call into question PwC's independence under the Loan Rule with respect to those funds, as well as the Company and all other funds in the Invesco Fund Complex.

In June 2016, the SEC Staff issued a "no-action" letter to another mutual fund complex (see Fidelity Management & Research Company et al., No-Action Letter) related to the audit independence issue described above. In that letter, the SEC Staff confirmed that it would not recommend enforcement action against an audit client that relied on audit services performed by an audit firm that was not in compliance with the Loan Rule in certain specified circumstances. The circumstances described in the no-action letter are substantially similar to the circumstances that called into question PwC's independence under the Loan Rule with respect to the Invesco Fund Complex, including the Company. We therefore believe that we can rely on the letter to continue to issue financial statements that are audited by PwC, and we intend to do so. In September 2017, the SEC Staff issued a letter extending the relief in the June 2016 no-action letter referenced above. The extension makes no changes to the circumstances in the original no-action letter and does not include a new expiration date, providing indefinite relief.

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

Risks Related to Accounting

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

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

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

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

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

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

Risks Related to Our Relationship with Our Manager

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

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

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

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

We are subject to conflicts of interest arising out of our relationship with Invesco and our Manager. Specifically, each of our officers and certain members of our board of directors are employees of our Manager or one of its affiliates. Our Manager and our executive officers may have conflicts between their duties to us and their duties to, and interests in, Invesco. We compete for investment opportunities directly with other clients of our Manager or Invesco and its subsidiaries. A substantial number of separate accounts managed by our Manager have exposure to our target assets. In addition, in the future our Manager may have additional clients or fund products that compete directly with us for investment opportunities.

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

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Our Manager would have a conflict in recommending our participation in any equity investment it manages.
Our Manager has a conflict of interest in recommending our participation in any equity investment it manages because the fees payable to it may be greater than the fees payable by us under the management agreement. With respect to equity investments we have made in partnerships managed by an affiliate of our Manager, our Manager has agreed to waive base management fees at the equity investment level to avoid duplication. To address any potential conflict of interest, we require the terms of any equity investment managed by our Manager to be approved by our audit committee consisting of our independent directors. However, there can be no assurance that all conflicts of interest will be eliminated.
The management agreement with our Manager was not negotiated on an arm's-length basis and may not be as favorable to us as if it had been negotiated with an unaffiliated third party and may be costly and difficult to terminate.
Our executive officers and certain members of our board of directors are employees of our Manager or one of its affiliates. Our management agreement with our Manager was negotiated between related parties and its terms, including fees payable, may not be as favorable to us as if it had been negotiated with an unaffiliated third party.
Termination of the management agreement with our Manager without cause is difficult and costly. Our independent directors review our Manager's performance and the management fees annually and the management agreement may be terminated annually upon the affirmative vote of at least two-thirds of our independent directors based upon: (1) our Manager's unsatisfactory performance that is materially detrimental to us, or (2) a determination that the management fees payable to our Manager are not fair, subject to our Manager's right to prevent termination based on unfair fees by accepting a reduction of management fees agreed to by at least two-thirds of our independent directors. Additionally, upon such a termination, the management agreement provides that we will pay our Manager a termination fee equal to three times the sum of our average annual management fee during the 24-month period before termination, calculated as of the end of the most recently completed fiscal quarter. These provisions may increase the cost of terminating the management agreement and adversely affect our ability to terminate our Manager without cause. If the management agreement is terminated and no suitable replacement is found to manage us, we may not be able to execute our business plan.
Pursuant to the management agreement, our Manager does not assume any responsibility other than to render the services called for thereunder and is not responsible for any action of our board of directors in following or declining to follow its advice or recommendations. Our Manager maintains a contractual, as opposed to a fiduciary, relationship with us. Under the terms of the management agreement, our Manager, its officers, stockholders, members, managers, partners, directors and personnel, any person controlling or controlled by our Manager and any person providing sub-advisory services to our Manager will not be liable to us, any subsidiary of ours, our directors, our stockholders or any subsidiary's stockholders or partners for acts or omissions performed in accordance with and pursuant to the management agreement, except because of acts constituting bad faith, willful misconduct, gross negligence, or reckless disregard of their duties under the management agreement, as determined by a final non-appealable order of a court of competent jurisdiction. We have agreed to indemnify our Manager, its officers, stockholders, members, managers, directors and personnel, any person controlling or controlled by our Manager and any person providing sub-advisory services to our Manager with respect to all expenses, losses, damages, liabilities, demands, charges and claims arising from acts of our Manager not constituting bad faith, willful misconduct, gross negligence, or reckless disregard of duties, performed in good faith in accordance with and pursuant to the management agreement.
Our board of directors approved very broad investment guidelines for our Manager and does not approve each investment and financing decision made by our Manager.
Our Manager is authorized to follow very broad investment guidelines. Our board of directors will periodically review our investment guidelines and our investment portfolio but does not, and is not required to, review all of our proposed investments, except that an investment in a security structured or issued by an entity managed by Invesco must be approved by a majority of our independent directors prior to such investment. In addition, in conducting periodic reviews, our board of directors may rely primarily on information provided to them by our Manager. Furthermore, our Manager may use complex strategies, and transactions entered into by our Manager may be costly, difficult or impossible to unwind by the time they are reviewed by our board of directors. Our Manager has great latitude within the broad parameters of our investment guidelines in determining the types and amounts of RMBS, CMBS, GSE

CRT, mortgage loans and financing arrangements it may decide are attractive investments for us, which could result in investment returns that are substantially below expectations or that result in losses, which would materially and adversely affect our business operations and results.

Risks Related to Our Capital Stock

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

The market price of our capital stock may be highly volatile and be subject to wide fluctuations. In addition, the trading volume in our capital stock may fluctuate and cause significant price variations to occur. If the market price of our capital stock declines significantly, our stockholders may be unable to resell their shares at or above the price our stockholders paid for their

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shares. We cannot assure you that the market price of our capital stock will not fluctuate or decline significantly in the future. Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our capital stock are included in the risk factors described in this Report.

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

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

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

We pay quarterly dividends to our stockholders in an amount such that we distribute all or substantially all of our REIT taxable income in each year, subject to certain adjustments. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected by a number of factors, including the risk factors described in this Report. All dividends will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, debt covenants, maintenance of our REIT qualification, applicable provisions of Maryland law and other factors as our board of directors may deem relevant from time to time. We believe that a change in any one of the following factors and other factors described in the risk factors in this Report could adversely affect our results of operations and impair our ability to pay dividends to our stockholders:

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

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

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

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

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

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

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

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

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

Risks Related to Our Organization and Structure

Certain provisions of Maryland law could inhibit changes in control.

Certain provisions of the Maryland General Corporation Law (the “MGCL”), may have the effect of deterring a third party from making a proposal to acquire us or of impeding a change in control under circumstances that otherwise could provide the holders of our common stock with the opportunity to realize a premium over the then-prevailing market price of our common stock. Under the MGCL, certain “business combinations” between us and an “interested stockholder” (defined generally as any person who beneficially owns 10% or more of our then outstanding voting capital stock) or an affiliate thereof are prohibited for five years after the most recent date on which the stockholder becomes an interested stockholder. Pursuant to the statute, our board of directors has by resolution exempted business combinations between us and any other person, provided that such business combination is first approved by our board of directors (including a majority of our directors who are not affiliates or associates of such person).

The “control share” provisions of the MGCL provide that “control shares” of a Maryland corporation have no voting rights except to the extent approved by our stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding votes entitled to be cast by the acquiror of control shares, our officers and our employees who are also our directors. Our bylaws contain a provision exempting from the control share acquisition statute any and all acquisitions by any person of shares of our stock. There can be no assurance that this provision will not be amended or eliminated at any time in the future.

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

Ownership limitations may restrict change of control of business combination opportunities in which our stockholders might receive a premium for their shares.

In order for us to qualify as a REIT, no more than 50% in value of our outstanding capital stock may be owned, directly or indirectly, by five or fewer individuals during the last half of any calendar year. To preserve our REIT qualification, among other purposes, our charter generally prohibits any person from directly or indirectly owning more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our capital stock or more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our common stock. This ownership limitation could have the effect of discouraging a takeover or other transaction in which holders of our common stock might receive a premium for their shares over the then prevailing market price or which holders might believe to be otherwise in their best interests.

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

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Our charter authorizes us to issue additional authorized but unissued shares of common or preferred stock. In addition, our board of directors may, without stockholder approval, amend our charter to increase the aggregate number of our shares of stock or the number of shares of stock of any class or series that we have authority to issue and classify or reclassify any unissued shares of common or preferred stock and set the preferences, rights and other terms of the classified or reclassified shares. As a result, our board of directors may establish a series of shares of common or preferred stock that could delay or prevent a transaction or a change in control that might involve a premium price for our shares of common stock or otherwise be in the best interest of our stockholders.

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

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

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

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

Tax Risks

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

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

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

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

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

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

If we fail to qualify as a REIT in any taxable year, and we do not qualify for certain statutory relief provisions, we would be required to pay U.S. federal income tax at regular corporate income tax rates on our taxable income, which would be determined without a deduction for dividends distributed to our stockholders. In such a case, we might need to borrow money or sell assets in order to pay our taxes. Our payment of income tax would decrease the amount of our income available for distribution to our stockholders or for investment and could have a significant adverse effect on the value of our equity. Furthermore, if we fail to maintain our qualification as a REIT, the distribution requirements for REIT qualification would no longer be relevant and could affect our distribution decisions. In addition, unless we were eligible for certain statutory relief provisions, we could not re-elect to qualify as a REIT until the fifth calendar year following the year in which we failed to qualify.

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Legislative, regulatory or administrative changes could adversely affect us or our stockholders.
Legislative, regulatory or administrative changes could be enacted or promulgated at any time, with either prospective or retroactive effect, and may adversely affect us and/or our stockholders.
On December 22, 2017, tax legislation commonly referred to as the Tax Cuts and Jobs Act was signed into law, generally applying in taxable years beginning after December 31, 2017. The Tax Cuts and Jobs Act makes significant changes to the U.S. federal income tax rules for taxation of individuals and corporations that may affect our stockholders and may directly or indirectly affect us. Most of the changes applicable to individuals are temporary and apply only to taxable years beginning after December 31, 2017 and before January 1, 2026, including the 20% deduction generally available to non-corporate taxpayers with respect to REIT dividends that are not capital gain dividends or qualified dividend income.
The IRS has issued significant proposed guidance under the Tax Cuts and Jobs Act, but guidance on additional issues, finalization of proposed guidance and possible technical corrections legislation may adversely affect us or our stockholders. In addition, further changes to the tax laws, unrelated to the Tax Cuts and Jobs Act, are possible. In particular, the federal income taxation of REITs may be modified, possibly with retroactive effect, by legislative, administrative or judicial action at any time.
You are urged to consult with your tax advisor with respect to the Tax Cuts and Jobs Act and other legislative, regulatory or administrative developments and proposals and their potential effect on investment in our common stock.
Complying with REIT requirements may force us to liquidate otherwise attractive investments.
To qualify as a REIT, we generally must ensure that at the end of each calendar quarter at least 75% of the value of our total assets consists of cash, cash items, government securities, including GSE CRT securities, and qualifying real estate assets, including certain MBS and certain mortgage loans. The remainder of our investments in securities (other than government securities, securities of our TRSs and qualifying real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, no more than 5% of the value of our assets can consist of the securities of any one issuer (other than government securities, securities of our TRSs and qualifying real estate assets), no more than 20% (beginning with our 2018 taxable year) of the value of our total securities can be represented by securities of one or more TRSs, and no more than 25% of the value of our assets may consist of “nonqualified publicly offered REIT debt instruments.” If we fail to comply with these requirements at the end of any quarter, we must correct the failure within 30 days after the end of such calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to dispose of otherwise attractive investments. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.
REIT distribution requirements could adversely affect our ability to execute our business plan and may require us to incur debt, sell assets or take other actions to make such distributions.
To qualify as a REIT, we must distribute dividends equal to at least 90% of our REIT taxable income (including certain items of non-cash income) to our stockholders each calendar year, determined without regard to the deduction for dividends paid and excluding net capital gains. To the extent that we satisfy the 90% distribution requirement, but distribute less than 100% of our taxable income, we will be subject to U.S. federal corporate income tax on our undistributed taxable income. In addition, we will incur a 4% nondeductible excise tax on the amount, if any, by which our distributions in any calendar year are less than a minimum amount specified under U.S. federal income tax laws. We intend distribute sufficient dividends to our stockholders to satisfy the 90% distribution requirement and to avoid both corporate income tax and the 4% nondeductible excise tax.
Our taxable income may be substantially different from our cash flow. Differences in timing between the recognition of taxable income and the actual receipt of cash may occur. For example, we may invest in debt instruments requiring us to accrue original issue discount (“OID”) or recognize market discount income that generate taxable income in excess of economic income or in advance of the corresponding cash flow. We may also acquire distressed debt investments that are subsequently modified by agreement with the borrower. If amendments to the outstanding debt are “significant modifications” under applicable Treasury Regulations, the modified debt may be considered to have been reissued to us

in a debt-for-debt exchange with the borrower, with a gain recognized by us to the extent that the principal amount of the modified debt exceeds our cost of purchasing it prior to modification. Under the Tax Cuts and Jobs Act, we may be required to take certain amounts in income no later than the time such amounts are reflected on certain financial statements. Finally, we may be required under the terms of the indebtedness that we incur, to use cash received from interest payments to make principal payment on that indebtedness, with the effect that we will recognize income but will not have a corresponding amount of cash available for distribution to our stockholders.

As a result of the foregoing, we may find it difficult or impossible to meet the REIT distribution requirements in certain circumstances. In such circumstances, we may be required to (1) sell assets in adverse market conditions, (2) borrow on

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unfavorable terms, (3) distribute amounts that would otherwise be invested or used to repay debt, or (4) make a taxable distribution of our shares of common stock in order to comply with the REIT distribution requirements. Thus, compliance with the REIT distribution requirements may hinder our ability to grow, which could adversely affect the value of our common stock.

We may choose to pay dividends in our own stock, in which case our stockholders may be required to pay income taxes in excess of the cash dividends received.

Under IRS Revenue Procedure 2017-45, as a publicly offered REIT we may give stockholders a choice, subject to various limits and requirements, of receiving a dividend in cash or in common stock of the REIT. As long as at least 20% of the total dividend is available in cash and certain other requirements are satisfied, the IRS will treat the stock distribution as a dividend (to the extent applicable rules treat such distribution as being made out of the REIT's earnings and profits). Taxable stockholders receiving such dividends will be required to include the full amount of the dividend income to the extent of our current and accumulated earnings and profits for federal income tax purposes. As a result, a U.S. stockholder may be required to pay income taxes with respect to such dividends in excess of the cash dividends received. If a U.S. stockholder sells the stock it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our stock at the time of the sale. Furthermore, with respect to non-U.S. stockholders, we may be required to withhold U.S. tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in stock. In addition, if a significant number of our stockholders determine to sell shares of our common stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our common stock.

Our ownership of and relationship with any TRS that we may form or acquire is subject to limitations, and a failure to comply with the limits would jeopardize our REIT qualification and may result in the application of a 100% excise tax.

A REIT may own up to 100% of the stock of one or more TRSs. A TRS may earn income that would not be qualifying income if earned directly by the parent REIT. Both the subsidiary and the REIT must jointly elect to treat the subsidiary as a TRS. Overall, no more than 20% (beginning with our 2018 taxable year) of the value of a REIT's assets may consist of stock or securities of one or more TRSs at the end of any calendar quarter. In addition, the TRS rules impose a 100% excise tax on certain transactions between a TRS and its parent REIT that are not conducted on an arm's length basis. There can be no assurance that we will be able to comply with the TRS limitations or to avoid application of the 100% excise tax discussed above.

Our domestic TRSs would pay U.S. federal, state and local income tax on their taxable income, and their after-tax net income would be available for distribution to us but would not be required to be distributed to us. If we were to organize a TRS as a non-U.S. corporation (or non-U.S. entity treated as a corporation for U.S. federal income tax purposes), we may generate income inclusions relating to the earnings of the non-U.S. TRS. Dividends from TRSs and deemed inclusions from non-U.S. TRSs, together with income that is not treated as qualifying income for purposes of the 75% gross income test cannot exceed 25% of our gross income in any year

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

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

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

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

In addition, we currently hold mezzanine loans, which are loans secured by equity interests in a partnership or limited liability company that directly or indirectly owns real property. In Revenue Procedure 2003-65, the IRS provided a safe harbor pursuant to which a mezzanine loan, if it meets each of the requirements contained in the Revenue Procedure, will be treated by the IRS as a real estate asset for purposes of the REIT asset tests, and interest derived from the mezzanine loan will be treated

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as qualifying mortgage interest for purposes of the 75% gross income test. Although the Revenue Procedure provides a safe harbor on which taxpayers may rely, it does not prescribe rules of substantive tax law. We acquire or originate mezzanine loans that do not meet all of the requirements for reliance on this safe harbor. The IRS could challenge treatment of such loans as real estate assets for purposes of the REIT asset and income tests, and if such a challenge were sustained, we could fail to qualify as a REIT.

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

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

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

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

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

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

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

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

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

We acquire debt instruments in the secondary market for less than their face amount. The discount at which such debt instruments are acquired may reflect doubts about their ultimate collectibility rather than current market interest rates.

The amount of such discount will nevertheless generally be treated as "market discount" for federal income tax purposes. Accrued market discount is reported as income when, and to the extent that, any payment of principal of the debt instrument is made. If we collect less on the debt instrument than our purchase price plus the market discount we had previously reported as income, we may not be able to benefit from any offsetting loss deductions.

Some of the debt instruments that we acquire may have been issued with OID. We will be required to report such original issue discount based on a constant yield method and will be taxed based on the assumption that all future projected payments

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due on such debt instruments will be made. If such debt instruments or MBS and GSE CRT turn out not to be fully collectible, an offsetting loss deduction will become available only in the later year that uncollectibility is provable.

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

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

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

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

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

The maximum tax rate for “qualified dividends” paid by corporations to individuals is currently 20%. Dividends paid by REITs, however, generally are not “qualified dividends” and generally are treated as ordinary income. For taxable years beginning after December 31, 2017 and before January 1, 2026, non-corporate taxpayers will be entitled to a 20% deduction for ordinary REIT dividends received, resulting in combination with the current top individual tax rate of 37%, a maximum tax rate of 29.6% on ordinary REIT dividends. The more favorable rates applicable to qualified dividends could cause potential investors who are individuals to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay qualified dividends, which could adversely affect the value of the stock of REITs, including our capital stock.

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

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

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Tax-exempt stockholders may realize unrelated business taxable income if we generate excess inclusion income.
If we acquire REMIC residual interests or equity interests in taxable mortgage pools (in a manner consistent with our REIT qualification) and generate "excess inclusion income," a portion of our dividends received by a tax-exempt stockholder will be treated as unrelated business taxable income. Excess inclusion income would also be subject to adverse federal income tax rules in the case of U.S. taxable stockholders and non-U.S. stockholders.
Changing the nature of our assets may complicate our ability to satisfy the REIT gross income and asset tests.
We have large holdings of RMBS that are qualifying assets for purposes of the REIT asset tests and generate interest income that is qualifying income for purposes of the REIT gross income tests. The REIT asset tests do not require that all assets be qualifying assets, nor do the REIT gross income tests require that all income be qualifying income. Our substantial RMBS holdings have given us room to make investments that may not qualify, all or in part, as real estate assets or that may generate income that may not qualify, all or in part, under one or both of the gross income tests. Reductions in our RMBS holdings would reduce our room for non-qualifying assets and income. In addition, if the market value or income potential of real estate-related investments declines as a result of increased interest rates, prepayment rates or other factors, we may need to increase our real estate investments and income and/or liquidate our non-qualifying assets in order to maintain our REIT qualification or exemption from the 1940 Act. If the decline in real estate asset values and/or income occurs quickly, this may be especially difficult to accomplish. This difficulty may be exacerbated by the illiquid nature of any non-real estate assets that we may own. We may have to make investment decisions that we otherwise would not make absent the REIT and Investment Company Act considerations. Furthermore, we may make investments in which the proper application of the REIT gross income and assets tests may not be clear. Mistakes in classifying assets or income for REIT purposes or in projecting the amount of qualifying and non-qualifying income could cause us to fail to qualify as a REIT.
Our qualification as a REIT may depend upon the accuracy of legal opinions or advice rendered or given or statements by the issuers of assets we acquire.
When purchasing securities, we may rely on opinions or advice of counsel for the issuer of such securities, or statements made in related offering documents, for purposes of determining, among other things, whether such securities represent debt or equity securities for U.S. federal income tax purposes, the value of such securities, and the extent to which those securities constitute qualified real estate assets for purposes of the REIT asset tests and produce qualified income for purposes of the 75% gross income test. The inaccuracy of any such opinions, advice or statements may adversely affect our ability to qualify as a REIT.
Uncertainty exists with respect to the treatment of our TBAs for purposes of the REIT asset and income tests.
There is no direct authority with respect to the qualification of TBAs as real estate assets or U.S. government securities for purposes of the 75% asset test or the qualification of income or gains from dispositions of TBAs as gains from the sale of real property (including interests in real property and interests in mortgages on real property) or other qualifying income for purposes of the 75% gross income test. In the event that TBAs were determined not to be qualifying assets for purposes of the 75% asset test or income or gains from dispositions of TBAs were determined not to be qualifying income for purposes of the 75% gross income test, we could fail to qualify as a REIT if, taking into account other nonqualifying assets or gross income, we failed the 75% asset test or the 75% gross income test.

Item 1B. Unresolved Staff Comments.
None.
Item 2. Properties.
Our principal executive office is located at 1555 Peachtree Street, NE, Suite 1800, Atlanta, Georgia 30309. As part of our management agreement, our Manager is responsible for providing office space and office services required in rendering services to us.
Item 3. Legal Proceedings.
From time to time, we may be involved in various claims and legal actions arising in the ordinary course of business. As of December 31, 2018, we were not involved in any such legal proceedings.
Item 4. Mine and Safety Disclosures.
Not applicable.

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PART II

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

Market Information

Our common stock is traded on the NYSE under the symbol “IVR.”

Holders

As of February 19, 2019, there were 106 common stockholders of record.

Performance Graph

The following graph matches the cumulative 5-year total return of holders of Invesco Mortgage Capital Inc.'s common stock with the cumulative total returns of the S&P 500 index and the FTSE NAREIT Mortgage REITs index. The graph assumes that the value of the investment in our common stock and in each of the indices (including reinvestment of dividends) was $100 on December 31, 2013 and tracks it through December 31, 2018.

Index	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Invesco Mortgage Capital Inc.	100.00	118.52	106.94	141.31	190.17	172.05
S&P 500	100.00	113.69	115.26	129.05	157.22	150.33
FTSE NAREIT Mortgage REITs	100.00	117.88	107.42	131.96	158.08	154.09

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

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Use of Proceeds

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

Repurchases of Equity Securities

In December 2011, our board of directors approved a share repurchase program with no stated expiration date. As of December 31, 2018, there were 18,163,982 common shares available for repurchase under the program. The shares may be repurchased from time to time through privately negotiated transactions or open market transactions, including under a trading plan in accordance with Rules 10b5-1 and 10b-18 under the Exchange Act or by any combination of such methods. The manner, price, number and timing of share repurchases will be subject to a variety of factors, including market conditions and applicable SEC rules.

During the year ended December 31, 2018, we repurchased 75,100 shares of our common stock owned by our Manager at a repurchase price of $15.23 per share for a net cost of $1.1 million as discussed in Item 1. Business of this Report on Form 10-K.

Equity Compensation Plans

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

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Item 6. Selected Financial Data.

The selected historical financial information as of and for the years ended December 31, 2018, 2017, 2016, 2015 and 2014 presented in the tables below have been derived from our audited financial statements. The information presented below is not necessarily indicative of the trends in our performance.

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

Balance Sheet Data

	As of December 31,				
$ in thousands	2018	2017	2016	2015	2014
Mortgage-backed and credit risk transfer securities, at fair value	17,396,642	18,190,754	14,981,331	16,065,935	17,248,895
Residential loans, held-for-investment (1)	—	—	—	—	3,365,003
Commercial loans, held-for-investment	31,582	191,808	273,355	209,062	145,756
Total assets (1)	17,813,505	18,657,256	15,706,238	16,767,309	21,218,097
Repurchase agreements	13,602,484	14,080,801	11,160,669	12,126,048	13,622,677
Secured loans	1,650,000	1,650,000	1,650,000	1,650,000	1,250,000
Asset-backed securities (1)	—	—	—	—	2,924,787
Exchangeable senior notes	—	143,231	397,041	394,573	392,113
Total stockholders' equity	2,286,697	2,630,491	2,241,560	2,241,035	2,610,315
Non-controlling interest	—	26,387	28,624	25,873	28,535
Total equity	2,286,697	2,656,878	2,270,184	2,266,908	2,638,850

(1) As of December 31, 2014, our consolidated balance sheet included assets and liabilities of consolidated variable interest entities ("VIEs"). We deconsolidated these VIEs in 2015. As of December 31, 2014, total assets of the consolidated VIEs were $3,380,597, and total liabilities of the consolidated VIEs were $2,938,512.

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Statements of Operations Data

	For the Years ended December 31,				
$ in thousands, except share amounts	2018	2017	2016	2015	2014
Interest income	643,016	545,055	478,682	650,132	687,080
Interest expense	338,868	196,591	157,354	277,973	281,895
Net interest income	304,148	348,464	321,328	372,159	405,185
(Reduction in) provision for loan losses	—	—	—	(213)	(142)
Net interest income after provision for loan losses	304,148	348,464	321,328	372,372	405,327
Other income (loss)	(326,892)	49,339	(21,824)	(203,697)	(570,001)
Total expenses	47,792	44,746	41,806	54,620	52,866
Net income (loss)	(70,536)	353,057	257,698	114,055	(217,540)
Net income (loss) attributable to non-controlling interest	254	4,450	3,287	1,344	(2,482)
Net income (loss) attributable to Invesco Mortgage Capital Inc.	(70,790)	348,607	254,411	112,711	(215,058)
Dividends to preferred stockholders	44,426	28,080	22,864	22,864	17,378
Net income (loss) attributable to common stockholders	(115,216)	320,527	231,547	89,847	(232,436)
Earnings per share:					
Net income (loss) attributable to common stockholders					
Basic	(1.03)	2.87	2.07	0.74	(1.89)
Diluted	(1.03)	2.75	1.98	0.74	(1.89)
Weighted average number of shares of common stock:					
Basic	111,637,035	111,610,393	111,973,404	121,377,585	123,104,934
Diluted	111,637,035	123,040,827	130,254,003	122,843,838	124,529,934

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

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

Overview

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

- Residential mortgage-backed securities (“RMBS”) that are guaranteed by a U.S. government agency such as the Government National Mortgage Association ("Ginnie Mae") or a federally chartered corporation such as the Federal National Mortgage Association (“Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac”) (collectively "Agency RMBS");
- Commercial mortgage-backed securities (“CMBS”) that are guaranteed by a U.S. government agency such as Ginnie Mae or a federally chartered corporation such as Fannie Mae or Freddie Mac”) (collectively “Agency CMBS”);
- RMBS that are not guaranteed by a U.S. government agency or a federally chartered corporation ("non-Agency RMBS");
- CMBS that are not guaranteed by a U.S. government agency or a federally chartered corporation (“non-Agency CMBS”);

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- Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises ("GSE CRT");
- Residential and commercial mortgage loans; and
- Other real estate-related financing arrangements.

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

Capital Activities

On December 14, 2018, we declared the following dividends:

- a dividend of $0.42 per share of common stock payable on January 28, 2019 to stockholders of record as of the close of business on December 26, 2018;
- a dividend of $0.4844 per share of Series A Preferred Stock payable on January 25, 2019 to stockholders of record as of the close of business on January 1, 2019;

On November 30, 2018, we redeemed all of the Operating Partnership Units ("OP Units") held by a wholly-owned Invesco Ltd. subsidiary for $21.8 million. The OP Units represented approximately 1.3% of the Operating Partnership prior to the redemption. We also repurchased 75,100 shares of common stock owned by our Manager for $1.1 million through our share repurchase program. The redemption price for the OP Units and common stock was equal to the market value of an equivalent number of shares of our registered common stock. As of December 31, 2018, we had authority to purchase 18,163,982 shares of our common stock through our share repurchase program.

In December 2017, we entered into an equity distribution agreement with a placement agent under which we may sell up to 17,000,000 shares of our common stock from time to time in at-the-market or privately negotiated transactions. These shares are registered with the SEC under our automatic shelf registration statement (as amended and/or supplemented). As of December 31, 2018, we have not sold any shares of common stock under the equity distribution agreement.

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Factors Impacting Our Operating Results

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

Market Conditions

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

Financial conditions tightened sharply in 2018, particularly during the fourth quarter as heightened volatility negatively impacted most financial markets. The S&P 500 Index returned (6.7%) for the year and (16.2%) during the fourth quarter. The Nasdaq Index saw even greater volatility, as it returned (4.0%) for 2018 and (21.3%) over the fourth quarter. The weakness was most pronounced during the latter half of the year as investors became increasingly concerned with the impact of tightening monetary policy by the Federal Open Market Committee ("FOMC"), the possibility of an escalating trade war with China, slowing global growth and possible signs that the U.S. had entered the later stages of the business cycle. Commodity prices were not immune from the volatility, as the CRB Commodity Price Index decreased by 14.9% during the fourth quarter, bringing the 2018 decrease to 14.2%. The price of oil fell dramatically, with WTI Crude falling by 58.6% during the fourth quarter, and 24.9% for the year.

Despite the volatility in the financial markets, the U.S. labor market remained strong. Monthly gains in Nonfarm Payrolls averaged 254,00 for the fourth quarter, outpacing the average increase of 220,00 for all of 2018. The unemployment rate remained close to multi-year lows at 3.9%. The consensus forecast for GDP growth in 2018 is 3%, but the consensus for 2019 and 2020 reflect some of the same concerns as listed above, with estimates of 2.3% and 2%, respectively.

Inflation remained subdued, with the U.S. Personal Consumption Expenditure Core Price Index dropping below the Federal Reserve’s inflation target of 2% in December after spending the first 11 months of the year between 2% and 3%. Implied breakeven rates on Treasury Inflation Protected securities, which reflect the markets expectation of future inflation rates, were sharply lower at year end, with the implied 2 year inflation rate at 0.66% and the implied 5 year inflation rate at 1.49%. The FOMC raised the federal funds target rate four times during the year, causing yields on shorter maturity Treasuries to increase at a faster pace than longer maturity Treasuries (commonly referred to as a "flattening" of the yield curve). With concerns over higher inflation receding during the fourth quarter, market expectations for further FOMC policy action changed dramatically. Over the course of the fourth quarter, the pricing of federal funds futures contracts went from implying an additional two increases during 2019 to implying no further increases during 2019, and cuts in 2020.

Structured securities performed poorly during 2018. Agency mortgages underperformed similar duration Treasuries for the full year, with nearly all the underperformance occurring during the fourth quarter. The outlook for Agency RMBS remains mixed, as the potential for continued interest rate and spread volatility and the tapering of reinvestment activity by the Federal Reserve weighs on the market. Prepayment activity remained muted through 2018, as rate incentives were not large enough to induce many homeowners to refinance, and supply and affordability issues also kept housing activity relatively muted.

During 2018, spreads (defined as the yield in excess of risk-free rates) on CMBS and GSE CRT securities widened during the market volatility of the fourth quarter; however, fundamentals in both commercial and residential housing remain on solid footing. Financing markets remained accommodative throughout 2018, though repurchase agreement rates moved higher in line with increases in the federal funds rate and typical year end bank balance sheet pressures.

As we move into 2019, concerns center around potentially slowing economic growth, uncertain Federal Reserve Policy and expanding trade disputes. We expect the U.S. will continue to experience moderate, albeit slowing, economic growth, and that core inflation will remain close to the Federal Reserve's policy objective of 2%. Other concerns include the actions of central banks, and their impact on the global economy, the sustainability of China's economic growth, and the potential impact of the Brexit process and resulting stress in the European banking system. In addition, the regulatory landscape for our repurchase agreement counterparties continues to evolve which may affect their funding methods and lending practices. While we are not directly subject to compliance with the implementation of rules regarding financial institutions, the effect of these regulations and others could impact our ability to finance our assets in the future.

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Investment Activities

The table below shows the allocation of our equity as of December 31, 2018 and 2017:

	As of December 31, 2018	2017
Agency RMBS and Agency CMBS	49 %	45 %
Commercial Credit [1]	33 %	35 %
Residential Credit [2]	18 %	20 %
Total	100%	100%

(1) Non-Agency CMBS, commercial loans and investments in unconsolidated ventures (that are included in Other Assets on our consolidated balance sheet) are considered commercial credit.

(2) Non-Agency RMBS, GSE CRT and a loan participation interest (that is included in Other Assets on our consolidated balance sheet) are considered residential credit.

The table below shows the breakdown of our investment portfolio as of December 31, 2018 and 2017:

$ in thousands	As of December 31, 2018	Percent of Total	2017	Percent of Total
Agency RMBS:				
30 year fixed-rate, at fair value	9,772,769	55.9 %	7,640,540	41.6 %
15 year fixed-rate, at fair value	424,254	2.4 %	2,974,782	16.2 %
Hybrid ARM, at fair value	554,201	3.2 %	1,719,385	9.3 %
ARM, at fair value	105,747	0.6 %	241,200	1.3 %
Agency CMO, at fair value	267,691	1.5 %	273,943	1.5 %
Agency CMBS, at fair value	1,002,510	5.7 %	—	— %
Non-Agency CMBS, at fair value	3,286,459	18.8 %	3,216,417	17.5 %
Non-Agency RMBS, at fair value	1,163,682	6.6 %	1,257,608	6.8 %
GSE CRT, at fair value	819,329	4.7 %	866,879	4.7 %
Loan participation interest, at fair value	54,981	0.3 %	—	— %
Commercial loans, at amortized cost	31,582	0.2 %	191,808	1.0 %
Investments in unconsolidated ventures	24,012	0.1 %	25,972	0.1 %
Total Investment portfolio	17,507,217	100.0%	18,408,534	100.0%

During 2018, we purchased $6.3 billion of mortgage-backed and credit risk transfer securities. Our purchases were concentrated in newly issued 30 year fixed-rate Agency RMBS ($4.5 billion), Agency CMBS ($988.8 million), non-Agency CMBS ($322.5 million) and non-Agency RMBS ($184.2 million). We funded our purchases through sales of securities and reinvestment of cash flows from principal repayments on securities and commercial loans. As of December 31, 2018 our holdings of 30 year fixed-rate Agency RMBS represented 56% of our total investment portfolio versus 42% of our total investment portfolio as of December 31, 2017. Available returns in non-Agency RMBS were relatively low compared to Agency RMBS, Agency CMBS and non-Agency CMBS as a result of credit spread tightening, limiting our reinvestment in the sector during 2018.

During the second half of 2018, we rotated out of seasoned Agency MBS, particularly the shorter duration 15 year fixed-rate and Hybrid ARM sectors, and purchased newly issued 30 year fixed-rate specified pools. The rise in interest rates, as well as the systematic reduction in the Federal Reserve’s balance sheet, resulted in wider spreads and produced accretive opportunities in the 30 year fixed-rate sector. We believe the impact on the sector from balance sheet reduction is mostly priced in, as spreads widened 15-20 basis points during the year, which provided an attractive entry point to increase our allocation at accretive levels. In addition to the sector rotation within Agency MBS, we sold a portion of our seasoned Agency MBS assets to reduce leverage as spreads widened during the latter half of the fourth quarter.

We began investing in Agency CMBS issued by Freddie Mac and Fannie Mae in 2018. We purchased these securities because we believe they have an attractive convexity and return on equity profile. They offer targeted exposure to multi-family

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loans and benefit from a guarantee of principal and interest payments from government agencies and federally chartered corporations. Further, the hedging costs are economical as they are less sensitive to interest rate risk given limited extension beyond initial expected maturity dates and underlying loan prepayment protection.

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

Our non-Agency CMBS portfolio generally consists of assets originated during and after 2010. These assets continued to benefit from rating agency upgrades, property price appreciation and limited supply. Non-Agency CMBS represents approximately 19% of our total investment portfolio as of December 31, 2018.

Our non-Agency RMBS portfolio represents approximately 7% of our total investment portfolio as of December 31, 2018. We primarily invest in RMBS collateralized by prime and Alt-A loans. In addition, we have invested in re-securitizations of real estate mortgage investment conduit ("Re-REMIC") RMBS and reperforming mortgage loans that we expect to provide attractive risk adjusted returns. We also invest in GSE CRTs, which have the added benefit of paying a floating rate coupon and reduce our need to hedge interest rate risk. The majority of our GSE CRT holdings are concentrated in 2013 and 2014 vintages, where reference loans have significant embedded home price appreciation. From a fundamental perspective, we continue to view GSE CRT as an attractive asset class based on the strength of the U.S. housing market and the strong performance of reference mortgage loans to date.

During the third quarter of 2018, we acquired a participation interest in a secured loan collateralized by mortgage servicing rights associated with Fannie Mae, Freddie Mac, and Ginnie Mae loans. The loan has a two year term subject to a one year extension at the borrower's option. We funded $55.0 million of the loan during 2018 and have committed to fund up to an additional $20.0 million.

As of December 31, 2018, our commercial real estate loan portfolio includes two mezzanine loans with a weighted average maturity of 1.7 years that we either purchased or originated. Our floating rate commercial real estate loan portfolio continued to benefit from favorable fundamentals and increasing LIBOR in 2018. The commercial real estate loan portfolio's weighted average loan-to-value ratio is approximately 73.5% based on the most recently attained independent property appraisals and the relevant loan amounts. For further details on our commercial loan portfolio, refer to Note 5 - "Commercial Loans Held-for-Investment" of our consolidated financial statements in Part IV, Item 15 of this Report. We evaluate the collectibility of our commercial loans held-for investment using the factors described in Note 2 - "Summary of Significant Accounting Policies" of our consolidated financial statements in Part IV, Item 15 of this Report. We determined that no provision for loan losses for our commercial loans was required as of December 31, 2018.

New credit risk retention rules for commercial mortgage-backed securities became effective under the Dodd-Frank Wall Street Reform and Consumer Protection Act on December 24, 2016. The credit risk retention rules require originators and/or an investor to retain at least 5% of the fair market value of the CMBS or sell all or a portion of this amount to a qualified third-party purchaser (“B-piece investor”). There is a minimum five year holding period for the retained investment. Despite the implementation of the credit risk retention rules, new issuance continued in 2018.

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Portfolio Characteristics

The table below illustrates the vintage distribution of our non-Agency RMBS, GSE CRT and non-Agency CMBS portfolio as of December 31, 2018 as a percentage of fair value:

	2003-2007	2008-2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
Prime	19.3 %	2.3 %	— %	— %	12.9 %	10.3 %	2.4 %	0.3 %	— %	15.6 %	63.1 %
Alt-A	27.6 %	— %	— %	— %	— %	— %	— %	— %	— %	— %	27.6 %
Re-REMIC (1)	0.6 %	4.4 %	1.9 %	1.5 %	0.8 %	— %	— %	— %	— %	— %	9.2 %
Subprime/reperforming	0.1 %	— %	— %	— %	— %	— %	— %	— %	— %	— %	0.1 %
Total Non-Agency	47.6 %	6.7 %	1.9 %	1.5 %	13.7 %	10.3 %	2.4 %	0.3 %	— %	15.6 %	100.0 %
GSE CRT	— %	— %	— %	— %	30.9 %	35.5 %	6.4 %	22.4 %	3.6 %	1.2 %	100.0 %
Non-Agency CMBS	— %	2.8 %	17.6 %	11.5 %	12.6 %	33.2 %	7.6 %	2.2 %	8.3 %	4.2 %	100.0 %

(1) For Re-REMICs, the table reflects the year in which the resecuritizations were issued. The vintage distribution of the securities that collateralize our Re-REMIC investments is 4.4% for 2005, 2.5% for 2006 and 93.1% for 2007.

The following table summarizes the credit enhancement provided to our Re-REMIC holdings as of December 31, 2018 and December 31, 2017.

Re-REMIC Subordination(1)	Percentage of Re-REMIC Holdings at Fair Value December 31, 2018	December 31, 2017
0% - 10%	49.8 %	34.5 %
10% - 20%	3.4 %	3.7 %
20% - 30%	16.9 %	12.3 %
30% - 40%	14.9 %	18.4 %
40% - 50%	1.8 %	9.6 %
50% - 60%	12.5 %	19.7 %
60% - 70%	0.7 %	1.8 %
Total	100.0 %	100.0 %

(1) Subordination refers to the credit enhancement provided to the Re-REMIC tranche held by us by any junior Re-REMIC tranche or tranches in a resecuritization. This figure reflects the percentage of the balance of the underlying securities represented by any junior tranche or tranches at the time of resecuritization. Generally, principal losses on the underlying securities in excess of the subordination amount would result in principal losses on the Re-REMIC tranche held by us. As of December 31, 2018, 70.1% of our Re-REMIC holdings are not senior tranches.

The tables below represent the geographic concentration of the underlying collateral for our non-Agency RMBS, GSE CRT and non-Agency CMBS portfolio as of December 31, 2018:

Non-Agency RMBS State	Percentage	GSE CRT State	Percentage	Non-Agency CMBS State	Percentage
California	44.6 %	California	19.1 %	California	14.8 %
New York	8.7 %	Texas	6.0 %	New York	14.6 %
Florida	6.6 %	New York	4.6 %	Texas	9.3 %
New Jersey	3.9 %	Virginia	4.3 %	Florida	6.4 %
Massachusetts	3.2 %	Florida	4.3 %	Illinois	4.4 %
Virginia	2.9 %	Illinois	3.9 %	Pennsylvania	4.0 %
Maryland	2.7 %	Massachusetts	3.4 %	New Jersey	3.5 %
Colorado	2.5 %	New Jersey	3.3 %	Ohio	3.1 %
Washington	2.5 %	Washington	3.3 %	Michigan	3.0 %
Illinois	2.4 %	Pennsylvania	3.2 %	Virginia	2.9 %
Other	20.0 %	Other	44.6 %	Other	34.0 %

Total	100.0 %	100.0 %	Total	100.0 %	

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Financing and Other Liabilities.

We enter into repurchase agreements to finance the majority of our target assets. These agreements are secured by our mortgage-backed securities and credit risk transfer securities and an investment in a loan participation interest. Repurchase agreements are generally settled on a short-term basis, usually ranging from one to twelve months, and bear interest at rates that have historically moved in close relationship to LIBOR. At each settlement date, we refinance each repurchase agreement at the market interest rate at that time. As of December 31, 2018, we had entered into repurchase agreements totaling $13.6 billion (2017: $14.1 billion).

Our wholly-owned subsidiary, IAS Services LLC, is a member of the FHLBI. As a member of the FHLBI, IAS Services LLC has borrowed funds from the FHLBI in the form of secured advances. As of December 31, 2018, IAS Services LLC had $1.65 billion in outstanding secured advances. For the year ended December 31, 2018, IAS Services LLC had weighted average borrowings of $1.65 billion with a weighted average borrowing rate of 2.15% and a weighted average maturity of 5.3 years.

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

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

$ in thousands	Collateralized borrowings under repurchase agreements and secured loans		
Quarter Ended	Quarter-end balance	Average quarterly balance	Maximum balance outstanding
March 31, 2017	13,939,899	13,901,254	14,086,600
June 30, 2017	13,768,948	13,716,749	13,768,948
September 30, 2017	15,738,838	15,010,514	15,738,838
December 31, 2017	15,730,801	15,762,094	15,815,972
March 31, 2018	15,561,137	15,536,093	15,561,137
June 30, 2018	15,352,321	15,275,972	15,352,321
September 30, 2018	16,028,518	15,973,428	16,078,388
December 31, 2018	15,252,484	15,836,597	16,144,062

In 2013, our Operating Partnership issued $400.0 million in Exchangeable Senior Notes (the "Notes"). We retired a portion of the Notes prior to their maturity and fully retired the Notes upon their maturity on March 15, 2018.

We have invested in unconsolidated ventures that are sponsored by an affiliate of our Manager. The unconsolidated ventures are structured as partnerships such that capital commitments are to be drawn down over the life of the partnership as investment opportunities are identified. At December 31, 2018, our undrawn capital and purchase commitments were $10.0 million.

We have invested in and funded our portion of a commitment in a loan participation. The remainder of our commitment under the agreement will be funded over the two year term of the loan based upon the financing needs of the borrower. As of December 31, 2018, we have an unfunded commitment of $20.0 million.

Hedging Instruments.

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

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

- available interest rate hedging may not correspond directly with the interest rate risk for which protection is sought;
- the duration of the hedges may not match the duration of the related liabilities;
- our counterparty in the hedging transaction may default on its obligation to pay;

- the credit quality of our counterparty on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the value of derivatives used for hedging may be adjusted from time-to-time in accordance with accounting rules to reflect changes in fair value.

As of December 31, 2018, we have entered into interest rate swap agreements designed to mitigate the effects of increases in interest rates under a portion of our borrowings. These swap agreements provide for fixed interest rates indexed off of one-month and three-month LIBOR and effectively fix the floating interest rates on $12.4 billion (2017: $9.1 billion) of borrowings. During the year ended December 31, 2018, we increased our leverage to fund the purchase of new investments and entered into interest rate swaps to hedge the interest rates on the associated repurchase agreement debt. We have two types of interest rate swap arrangements: bilateral interest rate swaps and centrally cleared interest rate swaps. We are required to pledge collateral on our interest rate swaps. As a result of rulebook changes governing central clearing activities effective January 3, 2017, the daily variation margin payment for centrally cleared interest rate swaps is characterized as settlement of the derivative itself rather than collateral. As a result of this change, cash collateral pledged on our centrally cleared interest rate swaps is settled against the fair value of these swaps.

As of December 31, 2018, we held $1.7 billion in notional amount of U.S. treasury futures contracts. During the year ended December 31, 2018, we settled futures contracts with a notional amount of $3.4 billion and realized a net loss of $86.3 million. Daily variation margin payment for futures is characterized as settlement of the derivative itself rather than collateral and is recorded as a realized gain or loss in our consolidated statement of operations.

As of December 31, 2018, we held $23.1 million (2017: $76.9 million) in notional amount of currency forward contracts. During the year ended December 31, 2018, we settled currency forward contracts with a notional amount of $262.4 million (2017: $269.8 million) and realized a net gain of $2.1 million (2017: loss of $5.1 million). We use currency forward contracts to help mitigate the potential impact of changes in foreign currency exchange rates on our investments denominated in Pound Sterling and Euro. Our commercial loan investment denominated in Pound Sterling was repaid by the borrower during 2018.

Book Value per Diluted Common Share

We calculate book value per diluted common share as follows:

	Years Ended December 31,		
In thousands except per share amounts	2018	2017	2016
Numerator (adjusted equity):			
Total equity	2,286,697	2,656,878	2,270,184
Less: Liquidation preference of Series A Preferred Stock	(140,000)	(140,000)	(140,000)
Less: Liquidation preference of Series B Preferred Stock	(155,000)	(155,000)	(155,000)
Less: Liquidation preference of Series C Preferred Stock	(287,500)	(287,500)	—
Total adjusted equity	1,704,197	2,074,378	1,975,184
Denominator (number of shares - diluted):			
Common stock outstanding	111,585	111,624	111,595
Non-controlling interest OP units	—	1,425	1,425
Number of shares - diluted	111,585	113,049	113,020
Book value per diluted common share	15.27	18.35	17.48

The reduction in the Federal Reserve’s balance sheet contributed to wider spreads in Agency MBS in 2018, while higher interest rates more than offset modest spread tightening to drive lower valuations of our residential and commercial credit investments. Although our interest rate hedges partially mitigated the impact of higher interest rates during the year, the company’s positive duration gap and underperformance in Agency MBS led to a decline in book value per diluted common share of (16.8)% in 2018.

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While our portfolio benefited from credit spread tightening in 2017, Agency MBS and commercial credit investments declined in valuation due to higher interest rates. However, these declines were more than offset by our interest rate hedges and increase in residential credit investment valuations. As a result, our book value per diluted common share increased 5.0% in 2017.

Refer to Item 7A. “Quantitative and Qualitative Disclosures About Market Risk” for interest rate risk and its impact on fair value.

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Critical Accounting Policies

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

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

We have elected the fair value option for all of our MBS purchased on or after September 1, 2016. Prior to September 1, 2016, we have also elected the fair value option for our RMBS IOs. We have also previously elected the fair value option for GSE CRTs purchased on or after August 24, 2015. Under the fair value option, changes in fair value are recognized in the consolidated statement of operations. In our view, the fair value option election more appropriately reflects the results of our operations because MBS and GSE CRT fair value changes are accounted for in the same manner as fair value changes in economic hedging instruments. As of December 31, 2018, $11.6 billion (December 31, 2017: $6.5 billion) or 67% (December 31, 2017: 36%) of our MBS and GSE CRT are accounted for under the fair value option.

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

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

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

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

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

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

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

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

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

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

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

Expected Impact of New Authoritative Guidance on Future Financial Information

In June 2016, new accounting guidance was issued for reporting credit losses for assets measured at amortized cost and available-for-sale securities. The new guidance significantly changes how entities will measure credit losses for most financial assets, including loans, that are not measured at fair value through net income. The guidance replaces the existing "incurred loss" model with an "expected loss" model for instruments measured at amortized cost, and require entities to record allowances for available-for-sale debt securities rather than reduce the carrying amount, as they do today under the other-than-temporary impairment model. The new guidance also simplifies the accounting model for purchased credit-impaired debt securities and loans. We are required to adopt the new guidance in the first quarter of 2020 by recording a cumulative effect adjustment to retained earnings as of January 1, 2020. We are currently evaluating the potential impacts of the new guidance and proposed amendments to the new guidance on our consolidated financial statements.

In June 2018, new accounting guidance was issued that aligns the measurement and classification for stock-based payments to non-employees with the guidance for stock-based payments to employees. Under the new guidance, the measurement of equity-classified non-employee awards will be fixed at the grant date. We are required to adopt the new guidance in the first quarter of 2019 by recording a cumulative effect adjustment to retained earnings as of January 1, 2019. We have determined that the new guidance does not have a material impact on our consolidated financial statements.

In August 2017, the FASB issued guidance to improve accounting for hedging activities. The purpose of this updated guidance is to better align a company's financial reporting for hedging activities with the economic objectives of those activities. We are required to adopt the new guidance in the first quarter of 2019. We have determined that this new guidance will not have an impact on our consolidated financial statements because we elected not to apply hedge accounting to all new derivative contracts entered into after January 1, 2014.

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Results of Operations

Our consolidated results of operations for the years ended December 31, 2018, 2017 and 2016 are summarized below:

	Years Ended December 31,		
In thousands except share amounts	2018	2017	2016
Interest Income			
Mortgage-backed and credit risk transfer securities	631,478	521,547	456,444
Commercial and other loans	11,538	23,508	22,238
Total interest income	643,016	545,055	478,682
Interest Expense			
Repurchase agreements	301,794	163,881	124,000
Secured loans	35,453	19,370	10,887
Exchangeable senior notes	1,621	13,340	22,467
Total interest expense	338,868	196,591	157,354
Net interest income	304,148	348,464	321,328
Other income (loss)			
Gain (loss) on investments, net	(327,700)	(19,704)	(17,542)
Equity in earnings (losses) of unconsolidated ventures	3,402	(1,327)	2,392
Gain (loss) on derivative instruments, net	(5,277)	18,155	(62,815)
Realized and unrealized credit derivative income (loss), net	(151)	51,648	61,143
Net loss on extinguishment of debt, net	(26)	(6,814)	—
Other investment income (loss), net	2,860	7,381	(5,002)
Total other income (loss)	(326,892)	49,339	(21,824)
Expenses			
Management fee — related party	40,722	37,556	34,541
General and administrative	7,070	7,190	7,265
Total expenses	47,792	44,746	41,806
Net income (loss)	(70,536)	353,057	257,698
Net income (loss) attributable to non-controlling interest	254	4,450	3,287
Net income (loss) attributable to Invesco Mortgage Capital Inc.	(70,790)	348,607	254,411
Dividends to preferred stockholders	44,426	28,080	22,864
Net income (loss) attributable to common stockholders	(115,216)	320,527	231,547
Earnings per share:			
Net income (loss) attributable to common stockholders			
Basic	(1.03)	2.87	2.07
Diluted	(1.03)	2.75	1.98
Weighted average number of shares of common stock:			
Basic	111,637,035	111,610,393	111,973,404
Diluted	111,637,035	123,040,827	130,254,003

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Interest Income and Average Earning Asset Yields

The table below presents information related to our average earning assets and earning asset yields as of and for the years ended December 31, 2018, 2017 and 2016.

	As of and for the Years Ended December 31,		
$ in thousands	2018	2017	2016
Average Earning Asset Balances [1]:			
Agency RMBS:			
15 year fixed-rate, at amortized cost	1,911,511	3,297,267	2,722,301
30 year fixed-rate, at amortized cost	8,867,942	5,874,757	3,646,480
ARM, at amortized cost	188,517	267,265	353,937
Hybrid ARM, at amortized cost	1,342,560	1,969,767	2,800,812
Agency-CMO, at amortized cost	258,457	302,060	375,888
Agency CMBS, at amortized cost	339,816	—	—
Non-Agency CMBS, at amortized cost	3,226,174	2,818,244	2,582,003
Non-Agency RMBS, at amortized cost	1,055,682	1,441,527	2,167,679
GSE CRT, at amortized cost	767,220	784,203	650,189
U.S. Treasury securities, at amortized cost	—	—	45,375
Commercial loans, at amortized cost	110,461	270,314	265,708
Loan participation interest	20,503	—	—
Average earning assets	18,088,843	17,025,404	15,610,372
Average Earning Asset Yields [2]:			
Agency RMBS:			
15 year fixed-rate	2.23 %	1.98 %	1.98 %
30 year fixed-rate	3.09 %	2.79 %	2.72 %
ARM	2.44 %	2.32 %	2.28 %
Hybrid ARM	2.40 %	2.26 %	2.12 %
Agency-CMO	3.01 %	1.54 %	2.47 %
Agency CMBS	3.30 %	— %	— %
Non-Agency CMBS	4.91 %	4.50 %	4.30 %
Non-Agency RMBS	7.11 %	6.22 %	4.97 %
GSE CRT [3]	3.40 %	2.58 %	0.98 %
U.S. Treasury securities	— %	— %	1.15 %
Commercial loans	9.54 %	8.70 %	8.35 %
Loan participation interest	6.10 %	— %	— %
Average earning asset yields	3.55 %	3.20 %	3.07 %

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

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

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

Our primary source of income is interest earned on our investment portfolio. We had average earning assets of approximately $18.1 billion during the year ended December 31, 2018 (2017: $17.0 billion; 2016: $15.6 billion). Average earning assets increased during the year ended December 31, 2018 compared to 2017 primarily due to a change in asset mix. During 2018, we reinvested $160.9 million of commercial loan repayments into newly issued 30 year fixed-rate Agency RMBS and Agency CMBS securities. We finance our Agency securities with repurchase agreement borrowings and commercial loans with equity.

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Average earning assets increased during the year ended December 31, 2017 compared to 2016 primarily due to the investment of proceeds from our August 2017 Series C Preferred Stock offering in 30 year fixed-rate Agency RMBS and non-Agency CMBS.

We earned interest income of $643.0 million (2017: $545.1 million; 2016: $478.7 million) during 2018. Our interest income consists of coupon interest and net premium amortization on MBS and GSE CRTs as well as interest income on commercial and other loans as shown in the table below.

	Years Ended December 31,		
$ in thousands	2018	2017	2016
Interest Income			
MBS and GSE CRT - coupon interest	689,240	616,697	574,692
MBS and GSE CRT - net premium amortization	(57,762)	(95,150)	(118,248)
MBS and GSE CRT - interest income	631,478	521,547	456,444
Commercial and other loans	11,538	23,508	22,238
Total interest income	643,016	545,055	478,682

Total interest income increased $98.0 million during the year ended December 31, 2018 compared to 2017 primarily due to the full year impact of investing the proceeds from our August 2017 Series C Preferred Stock offering and lower premium amortization. Net premium amortization decreased $37.4 million during 2018 primarily due to slower prepayments speeds on 30 year fixed-rate Agency RMBS and purchases of non-Agency CMBS securities at a discount during 2018. Interest income on commercial and other loans decreased $12.0 million during 2018 primarily due to commercial loan payoffs. Commercial loans held-for -investment were $31.6 million as of December 31, 2018 compared to $191.8 million as of December 31, 2017.

Total interest income increased $66.4 million during the year ended December 31, 2017 compared to 2016 primarily due to higher coupon interest on MBS and GSE CRT earning assets. MBS and GSE CRT average earning assets rose $1.4 billion to $17.0 billion in 2017 as detailed in the table above. Lower net premium amortization increased interest income by $23.1 million during the year ended December 31, 2017 primarily due to slower prepayment speeds. Interest income on our floating rate commercial real estate loans increased $1.3 million during the year ended December 31, 2017 primarily due to increasing LIBOR rates.

The yield on our average investment portfolio during the year ended December 31, 2018 was 3.55% (2017: 3.20%; 2016: 3.07%). Our average earning asset yields increased during the year ended December 31, 2018 compared to 2017 primarily due to purchases of new securities at higher yields, slower prepayment speeds and higher index rates on floating and adjustable rate assets.

The increase in our average earning asset yields for 2017 compared to 2016 was primarily due to slower prepayment speeds and higher index rates on floating and adjustable rate securities.

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Prepayment Speeds

Our RMBS and GSE CRT portfolio is subject to inherent prepayment risk primarily driven by changes in interest rates, which impacts the amount of premium and discount on the purchase of these securities that is recognized into interest income. Expected future prepayment speeds on our RMBS and GSE CRT portfolio are estimated on a quarterly basis. Generally, in an environment of falling interest rates, prepayment speeds will increase as homeowners are more likely to prepay their existing mortgage and refinance into a lower borrowing rate. If the actual prepayment speed during the period is faster than estimated, the amortization on securities purchased at a premium to par value will be accelerated, resulting in lower interest income recognized. Conversely, for securities purchased at a discount to par value, interest income will be reduced in periods where prepayment speeds were slower than expected. The standard measure of prepayment speeds is the constant prepayment rate, also known as the conditional prepayment rate or "CPR". CPR measures prepayments as a percentage of the current outstanding loan balance and is expressed as a compound annual rate. The following tables provide the three month CPR for our RMBS and GSE CRTs throughout 2018, 2017 and 2016.

	Three Months Ended			
	December 31, 2018	September 30, 2018	June 30, 2018	March 31, 2018
15 year Agency RMBS	8.8	10.9	10.6	9.2
30 year Agency RMBS	6.2	7.4	8.2	7.1
Agency/ Hybrid ARM RMBS	13.8	16.6	15.7	14.4
Non-Agency RMBS	9.1	10.5	12.0	11.6
GSE CRT	8.7	10.9	9.8	9.5
Weighted average CPR	7.3	8.9	10.2	9.2

	Three Months Ended			
	December 31, 2017	September 30, 2017	June 30, 2017	March 31, 2017
15 year Agency RMBS	9.3	10.2	9.5	8.1
30 year Agency RMBS	7.9	9.3	9.2	10.8
Agency/ Hybrid ARM RMBS	14.9	18.6	16.3	15.7
Non-Agency RMBS	11.8	15.3	12.6	13.3
GSE CRT	11.8	12.4	9.7	13.1
Weighted average CPR	9.9	12.2	11.2	11.7

	Three Months Ended			
	December 31, 2016	September 30, 2016	June 30, 2016	March 31, 2016
15 year Agency RMBS	8.9	9.5	10.4	10.2
30 year Agency RMBS	17.6	16.2	13.7	10.8
Agency/ Hybrid ARM RMBS	20.5	21.7	18.4	12.5
Non-Agency RMBS	17.9	16.5	15.2	11.1
GSE CRT	21.0	17.9	14.0	9.2
Weighted average CPR	16.3	16.1	14.9	11.2

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The following table presents net (premium amortization) discount accretion recognized on our MBS and GSE CRT portfolio during 2018, 2017 and 2016.

	Years Ended December 31,		
$ in thousands, except share data	2018	2017	2016
Agency RMBS and CMBS	(81,341)	(107,702)	(116,991)
Non-Agency CMBS	6,682	(4,268)	(11,536)
Non-Agency RMBS	19,968	18,769	13,529
GSE CRT	(3,071)	(1,949)	(3,192)
Other	—	—	(58)
Net (premium amortization) discount accretion	(57,762)	(95,150)	(118,248)

Net premium amortization decreased $37.4 million during 2018 primarily due to slower prepayments speeds on 30 year fixed-rate Agency RMBS and purchases of non-Agency CMBS securities at a discount during 2018.

Net premium amortization decreased $23.1 million during 2017 primarily due to slower weighted average prepayment speeds.

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

Interest Expense and Cost of Funds

The table below presents the components of interest expense for the years ended December 31, 2018, 2017 and 2016.

	For the Years Ended December 31,		
$ in thousands	2018	2017	2016
Interest Expense			
Interest expense on repurchase agreement borrowings	327,633	189,425	118,846
Amortization of net deferred (gain) loss on de-designated interest rate swaps	(25,839)	(25,544)	5,154
Repurchase agreements interest expense	301,794	163,881	124,000
Secured loans	35,453	19,370	10,887
Exchangeable senior notes	1,621	13,340	22,467
Total interest expense	338,868	196,591	157,354

Our interest expense on repurchase agreement borrowings rose $138.2 million for the year ended December 31, 2018 compared to 2017 primarily due to a $1.1 billion increase in average borrowings and increases in the federal funds rate during 2018. As discussed above, we reinvested $160.9 million of commercial loan repayments into newly issued 30 year fixed-rate Agency RMBS and Agency CMBS securities during 2018 and financed these purchases with repurchase agreement borrowings. Our commercial loans were financed with equity.

Our interest expense on repurchase agreement borrowings rose $70.6 million for the year ended December 31, 2017 compared to 2016 primarily due to a $1.3 billion increase in average borrowings. We increased our average borrowings in the second half of 2017 after investing the proceeds of our August 2017 offering of Series C Preferred Stock. Interest expense on repurchase agreement borrowings was also impacted by the increases in the federal funds target interest rate.

Our repurchase agreements interest expense includes amortization of deferred gains and losses on de-designated interest rate swaps as summarized in the table above. Amounts recorded in accumulated other comprehensive income (“AOCI”) before we discontinued cash flow hedge accounting for our interest rate swaps are reclassified to interest expense on repurchase agreements on the consolidated statements of operations as interest is accrued and paid on the related repurchase agreements over the remaining life of the interest rate swap agreements. Amortization of net deferred gains on de-designated interest rate swaps decreased our total interest expense by $25.8 million and $25.5 million during the years ended December 31, 2018 and

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December 31, 2017, respectively. Amortization of net deferred losses on de-designated interest rate swaps increased our total interest expense by $5.2 million during the year ended December 31, 2016. Most of our de-designated interest rate swap agreements that had deferred losses were fully amortized by the end of 2016. During the next twelve months, we estimate that $23.7 million of net deferred gains on de-designated interest rate swaps will be reclassified from other comprehensive income and recorded as a decrease to interest expense.

Our secured loans have floating rates that are based on the three-month FHLB swap rate plus a spread. Interest expense for our secured loans increased for the year ended December 31, 2018 compared to 2017 primarily due to higher borrowing rates as a result of the increases in the federal funds target interest rate. For the year ended December 31, 2018, our secured loans had a weighted average borrowing rate of 2.15% as compared to 1.17% for the year ended December 31, 2017.

Interest expense on our secured loans increased for the year ended December 31, 2017 compared to 2016 primarily due to higher borrowing rates as a result of the increases in the federal funds rate. For the year ended December 31, 2017, our secured loans had a weighted average borrowing rate of 1.17% as compared to 0.66% for the year ended December 31, 2016.

Our exchangeable senior notes matured in March 2018. Accordingly, interest expense on the Notes decreased compared to the same period in 2017. During the year ended December 31, 2017, interest expense on the Notes decreased compared to the same period in 2016 because we retired Notes with a par value of $256.6 million.

Our total interest expense during the year ended December 31, 2018 increased $142.3 million compared to 2017 primarily due to a $154.3 million increase in interest expense on repurchase agreement borrowings and secured loans that was partially offset by a $11.7 million decrease in interest expense on exchangeable senior notes.

Our total interest expense increased $39.2 million for the year ended December 31, 2017 compared to 2016 primarily due to a $79.1 million increase in interest expense on repurchase agreement borrowings and secured loans that was partially offset by a $30.7 million decrease in amortization of net deferred (gain) loss on de-designated interest rate swaps and a $9.1 million decrease in interest expense on exchangeable senior notes.

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The table below presents our average borrowings and cost of funds as of and for the years ended December 31, 2018, 2017 and 2016.

	As of and for the Years Ended December 31,		
$ in thousands	2018	2017	2016
Average Borrowings [(1)]:			
Agency RMBS [(2)]	11,178,636	10,494,355	8,872,694
Agency CMBS	311,024	—	—
Non-Agency CMBS [(2)]	2,586,509	2,323,689	2,176,963
Non-Agency RMBS	887,132	1,142,769	1,750,730
GSE CRT	677,545	643,070	459,738
U.S. Treasury securities	—	—	54,882
Exchangeable senior notes	28,646	228,846	395,910
Loan participation interest	15,377	—	—
Total average borrowings	15,684,869	14,832,729	13,710,917
Maximum borrowings during the period [(3)]	16,144,062	15,959,127	14,381,178
Average Cost of Funds [(4)]:			
Agency RMBS [(2)]	2.10%	1.18%	0.69%
Agency CMBS	2.31%	— %	— %
Non-Agency CMBS [(2)]	2.74%	1.73%	1.14%
Non-Agency RMBS	3.25%	2.49%	1.90%
GSE CRT	3.19%	2.55%	2.14%
U.S. Treasury securities	— %	— %	0.25%
Exchangeable senior notes	5.58%	5.83%	5.67%
Loan participation interest	4.04%	— %	— %
Cost of funds	2.16%	1.33%	1.15%
Effective cost of funds (non-GAAP measure) [(5)]	2.45%	2.02%	1.87%

(1) Average amounts for each period are based on weighted month-end balances.
(2) Agency RMBS and non-Agency CMBS average borrowings and average cost of funds include borrowings under repurchase agreements and secured loans.
(3) Amount represents the maximum borrowings at month-end during each of the respective periods.
(4) Average cost of funds is calculated by dividing annualized interest expense excluding amortization of net deferred gain (loss) on de-designated interest rate swaps by our average borrowings.
(5) For a reconciliation of cost of funds to effective cost of funds, see "Non-GAAP Financial Measures".

Total average borrowings rose $852.1 million in 2018 compared to 2017. As discussed above, total average borrowings increased primarily due to a change in asset mix. During 2018, we reinvested $160.9 million of commercial loan repayments into newly issued 30 year fixed-rate Agency RMBS and Agency CMBS securities. We finance our Agency securities with repurchase agreement borrowings and commercial loans with equity.

Total average borrowings rose $1.1 billion in 2017 compared to 2016. As discussed above, total average borrowings increased primarily because we entered into repurchase agreements to finance our increased holdings of 30 year fixed-rate Agency RMBS. The increase in our cost of funds for 2017 versus 2016 was primarily due to increases in the federal funds rate.

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Net Interest Income

The table below presents the components of net interest income for the years ended December 31, 2018, 2017 and 2016.

	For the Years Ended December 31,		
$ in thousands	2018	2017	2016
Interest Income			
Mortgage-backed and credit risk transfer securities	631,478	521,547	456,444
Commercial and other loans	11,538	23,508	22,238
Total interest income	643,016	545,055	478,682
Interest Expense			
Interest expense on repurchase agreement borrowings	327,633	189,425	118,846
Amortization of net deferred (gain) loss on de-designated interest rate swaps	(25,839)	(25,544)	5,154
Repurchase agreements interest expense	301,794	163,881	124,000
Secured loans	35,453	19,370	10,887
Exchangeable senior notes	1,621	13,340	22,467
Total interest expense	338,868	196,591	157,354
Net interest income	304,148	348,464	321,328
Net interest rate margin	1.39 %	1.87 %	1.92 %

Our net interest income, which equals total interest income less total interest expense, totaled $304.1 million (2017: $348.5 million; 2016: $321.3 million) for the year ended December 31, 2018. The decrease in net interest income for the year ended December 31, 2018 compared to 2017 was primarily driven by increases in interest rates that had a greater impact on total interest expense on variable rate debt than interest income on floating and variable rate assets. The increase in net interest income for the year ended December 31, 2017 compared to 2016 was primarily driven by interest income on higher average earning assets that exceeded the increase in interest expense driven by higher average borrowings and borrowing rates.

Our net interest rate margin, which equals the yield on our average assets for the period less the average cost of funds for the period, was 1.39% (2017: 1.87%; 2016: 1.92%) for the year ended December 31, 2018. The decrease in net interest rate margin for 2018 versus 2017 was primarily due to higher borrowing rates as a result of the increases in the federal funds rate. The decrease in net interest rate margin for 2017 versus 2016 was primarily due to the flattening of U.S. Treasury yield curve. The increase in the federal funds interest rate in 2017 had more impact on our short term repurchase agreement cost of funds than on our longer term asset yields.

Provision for Loan Losses

We evaluate the collectibility of our commercial loans held-for-investment using the factors described in Note 2 - "Summary of Significant Accounting Policies" of our consolidated financial statements in Part IV, Item 15 of this Report. We determined that no provision for loan losses for our commercial loans was required as of December 31, 2018 and 2017.

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Gain (Loss) on Investments, net

The table below summarizes the components of gain (loss) on investments, net for the years ended December 31, 2018, 2017 and 2016.

	Years Ended December 31,		
$ in thousands	2018	2017	2016
Realized gains and losses on sale of investments	(218,136)	(1,665)	(7,439)
Other-than-temporary impairment losses	(7,846)	(11,962)	(8,909)
Net unrealized gains and losses on MBS accounted for under the fair value option	(95,327)	(21,368)	(5,791)
Net unrealized gains and losses on GSE CRT accounted for under the fair value option	(6,370)	15,269	4,598
Net unrealized gains and losses on trading securities	(21)	22	(1)
Total	(327,700)	(19,704)	(17,542)

As part of our investment process, all of our mortgage-backed and credit risk transfer securities are continuously reviewed to determine if they continue to meet our risk and return targets. This process involves looking at changing market assumptions and the impact those assumptions will have on the individual securities. As discussed previously under "Investment Activities", we repositioned our portfolio in the second half of 2018 and sold approximately $5.0 billion of MBS in 2018 and realized a net loss of $218.1 million. The net loss on the sale of these securities did not impact book value as we report mortgage-backed securities at fair market value on our consolidated balance sheet.

We assess our investment securities for other-than-temporary impairment on a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either "temporary" or "other-than-temporary." For additional information regarding our assessment analysis of other-than temporary impairment on our investment securities, refer to Note 4 – “Mortgage-Backed and Credit Risk Transfer Securities” of our consolidated financial statements. We recorded $7.8 million in other-than-temporary-impairments ("OTTI") on RMBS interest-only and non-Agency RMBS securities for the year ended December 31, 2018 (2017: $12.0 million; 2016: $8.9 million).

We have elected the fair value option for all of our MBS purchased on or after September 1, 2016 and all of our GSE CRTs purchased on or after August 24, 2015. Prior to September 1, 2016, we had also elected the fair value option for our RMBS IOs. Under the fair value option, changes in fair value are recognized in income in the consolidated statements of operations. As of December 31, 2018, $11.6 billion or 67% (December 31, 2017: $6.5 billion or 36%) of our MBS and GSE CRT are accounted for under the fair value option.

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Equity in Earnings (Losses) of Unconsolidated Ventures

For the year ended December 31, 2018, we recorded equity in earnings of unconsolidated ventures of $3.4 million (2017: equity in losses of $1.3 million; 2016: equity in earnings of $2.4 million). We recorded equity in earnings for the year ended December 31, 2018 primarily due to realized gains on portfolio investments. We recorded equity in losses for the year ended December 31, 2017 primarily due to unrealized losses on portfolio investments which were partially offset by realized gains on portfolio asset dispositions.

Gain (Loss) on Derivative Instruments, net

We record all derivatives on our consolidated balance sheets at fair value. Changes in the fair value of our derivatives are recorded in gain (loss) on derivative instruments, net in our consolidated statements of operations. Net interest paid or received under our interest rate swaps is also recognized in gain (loss) on derivative instruments, net in our consolidated statements of operations.

The tables below summarize the components of our gain (loss) on derivative instruments, net for the years ended December 31, 2018, 2017 and 2016:

$ in thousands	Year ended December 31, 2018			
Derivative not designated as hedging instrument	Realized gain (loss) on derivative instruments, net	Contractual net interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Interest Rate Swaps	81,417	(20,015)	24,358	85,760
Futures Contracts	(86,318)	—	(7,836)	(94,154)
Currency Forward Contracts	2,088	—	1,046	3,134
TBAs	(17)	—	—	(17)
Total	(2,830)	(20,015)	17,568	(5,277)

$ in thousands	Year ended December 31, 2017			
Derivative not designated as hedging instrument	Realized gain (loss) on derivative instruments, net	Contractual net interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Interest Rate Swaps	72,894	(77,076)	28,316	24,134
Currency Forward Contracts	(5,056)	—	(923)	(5,979)
Total	67,838	(77,076)	27,393	18,155

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

Total	(57,943)	(104,804)	99,932	(62,815)

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As of December 31, 2018 and 2017, we held the following interest rate swaps whereby we receive interest at a one-month and three-month LIBOR rate:

$ in thousands	December 31, 2018				December 31, 2017			
Derivative instrument	Notional Amounts (1)	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)	Notional Amounts (1)	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)
Interest Rate Swaps	12,370,000	2.46 %	2.55 %	3.7	8,620,000	2.11 %	1.48 %	4.2

(1) Excludes $500.0 million of notional amount for an interest rate swap with a forward start date of 5/24/2018.

During the year ended December 31, 2018, we increased the notional amount of our swaps from $8.6 billion as of December 31, 2017 to $12.4 billion as of December 31, 2018. Contractual net interest expense decreased from $77.1 million for the year ended December 31, 2017 to $20.0 million for the year ended December 31, 2018 primarily as a result of higher LIBOR. Our average interest rate swap receive rate was 2.55% for the year ended December 31, 2018 versus 1.48% for the year ended December 31, 2017.

During the year ended December 31, 2017, we entered into swaps with a notional amount of $2.6 billion. Contractual net interest expense decreased from $104.8 million for the year ended December 31, 2016 to $77.1 million for the year ended December 31, 2017 primarily as a result of higher LIBOR. Our average receive rate was 1.48% for the year ended December 31, 2017 versus 0.79% for the year ended December 31, 2016.

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

As of December 31, 2018, we held $1.7 billion in notional amount of U.S. treasury futures contracts. Daily variation margin payment for futures is characterized as settlement of the derivative itself rather than collateral and is recorded as a realized gain or loss in our consolidated statement of operations. During the year ended December 31, 2018, we realized a net loss of $86.3 million on futures contracts primarily due to falling interest rates in the fourth quarter of 2018.

Realized and Unrealized Credit Derivative Income (Loss), net

The table below summarizes the components of realized and unrealized credit derivative income (loss), net for the years ended December 31, 2018, 2017 and 2016.

	Years Ended December 31,		
$ in thousands	2018	2017	2016
GSE CRT embedded derivative coupon interest	22,478	23,343	24,343
Gain (loss) on settlement of GSE CRT embedded derivatives	—	—	(6,017)
Change in fair value of GSE CRT embedded derivatives	(22,629)	28,305	42,817
Total	(151)	51,648	61,143

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During the year ended December 31, 2018, we recorded an unrealized loss on the change in the fair value of our GSE CRT embedded derivatives of $22.6 million because the decreases in valuations of the hybrid financial instruments exceeded the decreases in the valuation of the debt host contracts.

During the year ended December 31, 2017, we recorded an unrealized gain on the change in the fair value of our GSE CRT embedded derivatives of $28.3 million compared to an unrealized gain in the year ended December 31, 2016 of $42.8 million. While credit spreads continued to tighten throughout 2017, high premiums and shorter expected maturities resulted in a smaller increase in market prices.

Net Loss on Extinguishment of Debt

We retired a portion of our Exchangeable Senior Notes (the "Notes") prior to their maturity and fully retired the Notes upon their maturity on March 15, 2018.

During the year ended December 31, 2018, we retired $143.4 million of the Notes for a repurchase price of $143.4 million and realized a net loss on extinguishment of debt of $26,000. During the year ended December 31, 2017, we retired $256.6 million of the Notes for a repurchase price of $262.1 million and realized a net loss on extinguishment of debt of $6.8 million.

Other Investment Income (Loss), net

Other investment income (loss), net primarily consists of (i) quarterly dividends from FHLBI stock and an investment in an exchange-traded fund and (ii) foreign exchange rate gains and losses related to a commercial loan investment denominated in a foreign currency. The table below summarizes the components of other investment income (loss), net for the years ended December 31, 2018, 2017 and 2016.

	Years Ended December 31,		
$ in thousands	2018	2017	2016
Dividend income	3,790	3,247	3,185
Gain (loss) on foreign currency transactions, net	(930)	4,134	(8,187)
Total	2,860	7,381	(5,002)

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

We incurred foreign currency losses on the revaluation of a commercial loan investment (notional amount of £34.5 million) for the year ended December 31, 2018 due to a decline in the Pound Sterling/U.S. Dollar foreign exchange rate. This commercial loan was repaid by the borrower during 2018. We incurred foreign currency gains on the revaluation of this commercial loan investment for the year ended December 31, 2017 due to an improvement in the Pound Sterling/ U.S. Dollar foreign exchange rate. We incurred foreign currency losses for the year ended December 31, 2016 due to the significant decline in the Pound Sterling/ U.S. Dollar foreign exchange rate. We enter into currency forward contracts as an economic hedge against our foreign currency exposure. Changes in the fair value of our currency forward contracts are recognized in gain (loss) derivative instruments, net in the consolidated statements of operations. During the year ended December 31, 2018, we recognized net gains of $3.1 million on our currency forward contracts (2017: net losses of $6.0 million; 2016: net gains of $10.6 million).

Expenses

For the year ended December 31, 2018, we incurred management fees of $40.7 million (2017: $37.6 million; 2016: $34.5 million), which are payable to our Manager under our management agreement. Management fees increased for the year ended December 31, 2018 compared to 2017 primarily due to the full year impact of issuing Series C Preferred Stock in August 2017.

Management fees increased for the year ended December 31, 2017 compared to 2016 primarily due to (i) a cumulative one-time adjustment of $2.3 million in 2016 related to a prior adjustment for the accounting for premiums and discounts associated with non-Agency RMBS not of high credit quality and (ii) a $1.6 million partial year impact of issuing preferred stock in August 2017.

For the year ended December 31, 2018, our general and administrative expenses not covered under our management agreement amounted to $7.1 million (2017: $7.2 million; 2016: $7.3 million). General and administrative expenses not covered

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under our management agreement primarily consist of directors and officers insurance, legal costs, accounting, auditing and tax services, filing fees and miscellaneous general and administrative costs.

Net Income (Loss) attributable to Common Stockholders

For the year ended December 31, 2018, our net loss attributable to common stockholders was $115.2 million (2017: $320.5 million net income; 2016: $231.5 million net income) or $1.03 basic and $1.03 diluted net loss per average share available to common stockholders (2017: $2.87 basic and $2.75 diluted net income per average share available to common stockholders; 2016: $2.07 basic and $1.98 diluted net income per average share available to common stockholders).

For the year ended December 31, 2018, we reported a net loss attributable to common stockholders compared to net income in 2017 due to: (i) net losses on investment of $327.7 million versus net losses on investments of $19.7 million in the 2017 period; (ii) net losses on credit derivatives of $151,000 versus net gains on credit derivatives of $51.6 million in the 2017 period; (iii) lower net interest income of $304.1 million versus $348.5 million in the 2017 period; and higher dividends to preferred stockholders of $44.4 million compared to $28.1 million in the 2017 period.

For the year ended December 31, 2017, the $89.0 million increase in net income attributable to common stockholders was primarily due to (i) net gains on derivatives instruments of $18.2 million versus net losses on derivatives instruments of $62.8 million in the 2016 period, (ii) higher net interest income of $348.5 million versus $321.3 million in the 2016 period and (iii) higher dividends to preferred stockholders of $28.1 million versus $22.9 million in the 2016 period. As discussed above, net interest income and dividends to preferred stockholders were both higher in 2017 due to the issuance of $287.5 million of Series C Preferred Stock in August 2017.

For further information on the changes in net gains (losses) on investments and derivative instruments and realized and unrealized credit derivative income (loss), net in the 2018, 2017 and 2016 period, see preceding discussion under "Gain (loss) on Investments, net", "Gain (Loss) on Derivative Instruments, net," and "Realized and Unrealized Credit Derivative Income (Loss), net,"

Non-GAAP Financial Measures

We use the following non-GAAP financial measures to analyze the Company's operating results and believe these financial measures are useful to investors in assessing our performance as further discussed below:

- core earnings (and by calculation, core earnings per common share),
- effective interest income (and by calculation, effective yield),
- effective interest expense (and by calculation, effective cost of funds),
- effective net interest income (and by calculation, effective interest rate margin), and
- repurchase agreement debt-to-equity ratio.

The most directly comparable U.S. GAAP measures are:

- net income (loss) attributable to common stockholders (and by calculation, basic earnings (loss) per common share),
- total interest income (and by calculation, earning asset yield),
- total interest expense (and by calculation, cost of funds),
- net interest income (and by calculation, net interest rate margin), and
- debt-to-equity ratio.

The non-GAAP financial measures used by management should be analyzed in conjunction with U.S. GAAP financial measures and should not be considered substitutes for U.S. GAAP financial measures. In addition, the non-GAAP financial measures may not be comparable to similarly titled non-GAAP financial measures of our peer companies.

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Core Earnings

We calculate core earnings as U.S. GAAP net income (loss) attributable to common stockholders adjusted for (gain) loss on investments, net; realized (gain) loss on derivative instruments, net; unrealized (gain) loss on derivative instruments, net; realized and unrealized (gain) loss on GSE CRT embedded derivatives, net; (gain) loss on foreign currency transactions, net; amortization of net deferred (gain) loss on de-designated interest rate swaps; net loss on extinguishment of debt; and cumulative adjustments attributable to non-controlling interest. We may add and have added additional reconciling items to our core earnings calculation as appropriate.

We believe the presentation of core earnings provides a consistent measure of operating performance by excluding the impact of gains and losses described above from operating results. We exclude the impact of gains and losses because gains and losses are not accounted for consistently under U.S. GAAP. Under U.S. GAAP, certain gains and losses are reflected in net income whereas other gains and losses are reflected in other comprehensive income. For example, a portion of our mortgage-backed securities are classified as available-for-sale securities, and we record changes in the valuation of these securities in other comprehensive income on our consolidated balance sheet. We elected the fair value option for our mortgage-backed securities purchased on or after September 1, 2016, and changes in the valuation of these securities are recorded in other income (loss) in our consolidated statement of operations. In addition, certain gains and losses represent one-time events.

We believe that providing transparency into core earnings enables our investors to consistently measure, evaluate and compare our operating performance to that of our peers over multiple reporting periods. However, we caution that core earnings should not be considered as an alternative to net income (determined in accordance with U.S. GAAP), or as an indication of our cash flow from operating activities (determined in accordance with U.S. GAAP), a measure of our liquidity, or as an indication of amounts available to fund our cash needs, including our ability to make cash distributions.

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

	Years Ended December 31,		
$ in thousands, except per share data	2018	2017	2016
Net income (loss) attributable to common stockholders	(115,216)	320,527	231,547
Adjustments:			
(Gain) loss on investments, net	327,700	19,704	17,542
Realized (gain) loss on derivative instruments, net (1)	2,830	(67,838)	57,943
Unrealized (gain) loss on derivative instruments, net (1)	(17,568)	(27,393)	(99,932)
Realized and unrealized (gain) loss on GSE CRT embedded derivatives, net (2)	22,629	(28,305)	(36,800)
(Gain) loss on foreign currency transactions, net (3)	930	(4,134)	8,187
Amortization of net deferred (gain) loss on de-designated interest rate swaps (4)	(25,839)	(25,544)	5,154
Net loss on extinguishment of debt	26	6,814	—
Subtotal	310,708	(126,696)	(47,906)
Cumulative adjustments attributable to non-controlling interest	(2,536)	1,597	653
Preferred stock dividend declared but not accumulated (5)	—	(2,870)	—
Core earnings attributable to common stockholders	192,956	192,558	184,294
Basic earnings (loss) per common share	(1.03)	2.87	2.07
Core earnings per share attributable to common stockholders (6)	1.73	1.73	1.65

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

	Years Ended December 31,		
$ in thousands	2018	2017	2016
Realized gain (loss) on derivative instruments, net	(2,830)	67,838	(57,943)
Unrealized gain (loss) on derivative instruments, net	17,568	27,393	99,932
Contractual net interest expense	(20,015)	(77,076)	(104,804)

Gain (loss) on derivative instruments, net	(5,277)	18,155	(62,815)

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

	Years Ended December 31,		
$ in thousands	2018	2017	2016
Realized and unrealized gain (loss) on GSE CRT embedded derivatives, net	(22,629)	28,305	36,800
GSE CRT embedded derivative coupon interest	22,478	23,343	24,343
Realized and unrealized credit derivative income (loss), net	(151)	51,648	61,143

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

	Years Ended December 31,		
$ in thousands	2018	2017	2016
Dividend income	3,790	3,247	3,185
Gain (loss) on foreign currency transactions, net	(930)	4,134	(8,187)
Other investment income (loss), net	2,860	7,381	(5,002)

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

	Years Ended December 31,		
$ in thousands	2018	2017	2016
Interest expense on repurchase agreements outstanding	327,633	189,425	118,846
Amortization of net deferred (gain) loss on de-designated interest rate swaps	(25,839)	(25,544)	5,154
Repurchase agreements interest expense	301,794	163,881	124,000

(5) Cumulative dividends are charged to retained earnings when declared or earned under U.S. GAAP. Prior to 2017, we declared quarterly dividends on Series B Preferred Stock prior to dividends accumulating. As of September 14, 2017, we declared cumulative dividends on Series B Preferred Stock from the date of issuance through December 27, 2017. In December 2017, the Company deferred declaring its next dividend on Series B Preferred Stock to February 2018. Due to the change in declaration date, we recorded $9.1 million in Series B Preferred Stock dividends for the year ended December 31, 2017 compared to $12.0 million for the year ended December 31, 2016. We reduced core earnings for the quarter ended December 31, 2017 for the cumulative impact of deferring the declaration date to February 2018 because we consider all dividends accumulated during a quarter a current component of our capital costs regardless of the dividend declaration date.

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

The components of core income for the years ended December 31, 2018, 2017 and 2016 are:

	Years Ended December 31,		
$ in thousands	2018	2017	2016
Effective net interest income[1]	280,772	269,187	246,021
Dividend income	3,790	3,247	3,185
Equity in earnings (losses) of unconsolidated ventures	3,402	(1,327)	2,392
Total expenses	(47,792)	(44,746)	(41,806)
Total core earnings	240,172	226,361	209,792
Dividends to preferred stockholders	(44,426)	(28,080)	(22,864)
Preferred stock dividend declared but not accumulated	—	(2,870)	—
Core earnings attributable to non-controlling interest	(2,790)	(2,853)	(2,634)
Core earnings attributable to common stockholders	192,956	192,558	184,294

(1) See below for a reconciliation of net interest income to effective net interest income, a non-GAAP measure.

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Core earnings for the year ended December 31, 2018 increased $0.4 million from 2017 primarily due to (i) an $11.6 million increase in effective net interest income and (ii) equity in earnings of unconsolidated ventures of $3.4 million in 2018 compared to equity in losses of $1.3 million in 2017 that was offset by (i) a $13.5 million increase in accumulated preferred stock dividends and (ii) a $3.0 million increase in management fees and other expenses. Higher preferred dividends and management fees in 2018 are due to the full year impact of the Company's Series C Preferred Stock offering in August 2017.

Core earnings for the year ended December 31, 2017 increased $8.3 million from 2016 primarily due to a $23.2 million increase in effective net interest income that was partially offset by (i) equity in losses of unconsolidated ventures of $1.3 million in 2017 compared to equity in earnings of $2.4 million in 2016, (ii) a $3.0 million increase in management fees and (iii) an $8.1 million increase in preferred stock dividends. Higher preferred dividends and management fees in 2017 are due to the partial year impact of the Company's Series C Preferred Stock offering in August 2017.

See below for a discussion of changes in effective net interest income from 2016 through 2018.

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

We calculate effective interest income (and by calculation, effective yield) as U.S. GAAP total interest income adjusted for GSE CRT embedded derivative coupon interest that is recorded as realized and unrealized credit derivative income (loss), net. We include our GSE CRT embedded derivative coupon interest in effective interest income because GSE CRT coupon interest is not accounted for consistently under U.S. GAAP. We account for GSE CRTs purchased prior to August 24, 2015 as hybrid financial instruments, but we have elected the fair value option for GSE CRTs purchased on or after August 24, 2015. Under U.S. GAAP, coupon interest on GSE CRTs accounted for using the fair value option is recorded as interest income, whereas coupon interest on GSE CRTs accounted for as hybrid financial instruments is recorded as realized and unrealized credit derivative income (loss). We add back GSE CRT embedded derivative coupon interest to our total interest income because we consider GSE CRT embedded derivative coupon interest a current component of our total interest income irrespective of whether we elected the fair value option for the GSE CRT or accounted for the GSE CRT as a hybrid financial instrument.

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

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