Ellington Residential Mortgage REIT
Form 10-Q
May 04, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 001-35896
Ellington Residential Mortgage REIT
(Exact Name of Registrant as Specified in Its Charter)

Maryland	46-0687599
(State or Other Jurisdiction of Incorporation)	(IRS Employer Identification No.)

53 Forest Avenue
Old Greenwich, CT 06870
(Address of principal executive offices, zip code)
(203) 698-1200
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	¨	Accelerated Filer	x
Non-Accelerated Filer (do not check if a smaller reporting company)	¨	Smaller Reporting Company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at April 29, 2016
Common Shares of Beneficial Interest, $0.01 par value per share	9,117,183

ELLINGTON RESIDENTIAL MORTGAGE REIT
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PART I. FINANCIAL INFORMATION
Item 1. Consolidated Financial Statements (unaudited)
ELLINGTON RESIDENTIAL MORTGAGE REIT
CONSOLIDATED BALANCE SHEET
(UNAUDITED)

	March 31, 2016	December 31, 2015
(In thousands except for share amounts)		
ASSETS		
Cash and cash equivalents	$41,242	$40,166
Mortgage-backed securities, at fair value	1,173,593	1,242,266
Due from brokers	30,206	33,297
Financial derivatives–assets, at fair value	1,635	2,183
Reverse repurchase agreements	69,575	78,632
Receivable for securities sold	64,243	155,526
Interest receivable	4,092	4,325
Other assets	523	289
Total Assets	$1,385,109	$1,556,684
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Repurchase agreements	$1,133,841	$1,222,719
Payable for securities purchased	16,433	98,949
Due to brokers	127	439
Financial derivatives–liabilities, at fair value	18,284	4,725
U.S. Treasury securities sold short, at fair value	69,607	78,447
Dividend payable	4,103	4,111
Accrued expenses	447	533
Management fee payable	528	545
Interest payable	1,382	1,361
Total Liabilities	1,244,752	1,411,829
SHAREHOLDERS' EQUITY		
Preferred shares, par value $0.01 per share, 100,000,000 shares authorized; (0 shares issued and outstanding, respectively)	—	—
Common shares, par value $0.01 per share, 500,000,000 shares authorized; (9,117,183 and 9,135,103 shares issued and outstanding, respectively)	92	92
Additional paid-in-capital	180,871	181,027
Accumulated deficit	(40,606)	(36,264)
Total Shareholders' Equity	140,357	144,855
Total Liabilities and Shareholders' Equity	$1,385,109	$1,556,684

ELLINGTON RESIDENTIAL MORTGAGE REIT
CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

	Three Month Period Ended March 31, 2016	Three Month Period Ended March 31, 2015
(In thousands except for per share amounts)		
INTEREST INCOME (EXPENSE)		
Interest income	$9,651	$10,280
Interest expense	(2,051)	(1,258)
Total net interest income	7,600	9,022
EXPENSES		
Management fees	528	610
Professional fees	218	143
Compensation expense[1]	151	193
Other operating expenses[1]	454	470
Total expenses	1,351	1,416
OTHER INCOME (LOSS)		
Net realized gains (losses) on securities	3,010	6,722
Net realized gains (losses) on financial derivatives	(3,996)	(8,743)
Change in net unrealized gains (losses) on securities	8,633	5,186
Change in net unrealized gains (losses) on financial derivatives	(14,135)	(7,094)
Total other income (loss)	(6,488)	(3,929)
NET INCOME (LOSS)	$(239)	$3,677
NET INCOME (LOSS) PER COMMON SHARE:		
Basic and Diluted	$(0.03)	$0.40
CASH DIVIDENDS PER COMMON SHARE:		
Dividends declared	$0.45	$0.55

(1) Conformed to current period presentation.

See Notes to Consolidated Financial Statements
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ELLINGTON RESIDENTIAL MORTGAGE REIT
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(UNAUDITED)

(In thousands except for share amounts)	Common Shares	Common Shares, par value	Preferred Shares	Preferred Shares, par value	Additional Paid-in-Capital	Accumulated (Deficit) Earnings	Total
BALANCE, December 31, 2014	9,149,274	$ 91	—	$ —	$ 181,282	$ (18,008)	$ 163,365
Share based compensation					30		30
Dividends declared						(5,032)	(5,032)
Net income						3,677	3,677
BALANCE, March 31, 2015	9,149,274	91	—	—	181,312	(19,363)	162,040
BALANCE, December 31, 2015	9,135,103	92	—	—	181,027	(36,264)	144,855
Share based compensation					40		40
Repurchase of common shares	(17,920)	—	—	—	(196)		(196)
Dividends declared						(4,103)	(4,103)
Net loss						(239)	(239)
BALANCE, March 31, 2016	9,117,183	$ 92	—	$ —	$ 180,871	$ (40,606)	$ 140,357

See Notes to Consolidated Financial Statements
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ELLINGTON RESIDENTIAL MORTGAGE REIT
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

(In thousands)	Three Month Period Ended March 31, 2016	Three Month Period Ended March 31, 2015
Cash flows provided by (used in) operating activities:		
Net income (loss)	$ (239)	$ 3,677
Reconciliation of net income (loss) to net cash provided by (used in) operating activities:		
Net realized (gains) losses on securities	(3,010)	(6,722)
Change in net unrealized (gains) losses on securities	(8,633)	(5,186)
Net realized (gains) losses on financial derivatives	3,996	8,743
Change in net unrealized (gains) losses on financial derivatives	14,135	7,094
Amortization of premiums and accretion of discounts (net)	1,850	2,477
Share based compensation	40	30
(Increase) decrease in assets:		
Due from brokers	3,091	(10,209)
Interest receivable	233	342
Other assets	(234)	(293)
Increase (decrease) in liabilities:		
Due to brokers	(312)	1,026
Accrued expenses	(86)	18
Interest payable	21	164
Management fees payable	(17)	59
Net cash provided by (used in) operating activities	10,835	1,220
Cash flows provided by (used in) investing activities:		
Purchases of securities	(723,002)	(482,987)
Proceeds from sale of securities	782,510	584,903
Principal repayments of mortgage-backed securities	30,044	31,207
Proceeds from investments sold short	157,931	214,417
Repurchase of investments sold short	(169,090)	(165,926)
Proceeds from disposition of financial derivatives	3,004	4,457
Purchase of financial derivatives	(7,028)	(13,200)
Payments made on reverse repurchase agreements	(4,546,558)	(2,092,173)
Proceeds from reverse repurchase agreements	4,555,615	2,043,187
Net cash provided by (used in) investing activities	83,426	123,885
Cash flows provided by (used in) financing activities:		
Repurchase of common shares	(196)	—
Dividends paid	(4,111)	(5,032)
Borrowings under repurchase agreements	559,785	1,421,636
Repayments of repurchase agreements	(648,663)	(1,533,606)
Cash provided by (used in) financing activities	(93,185)	(117,002)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,076	8,103
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	40,166	45,237
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 41,242	$ 53,340

Supplemental disclosure of cash flow information:		
Interest paid	$ 2,030	$ 1,094
Dividends payable	$ 4,103	$ 5,032

See Notes to Consolidated Financial Statements
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ELLINGTON RESIDENTIAL MORTGAGE REIT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2016
(UNAUDITED)

1. Organization and Investment Objective

Ellington Residential Mortgage REIT, or "EARN," was formed as a Maryland real estate investment trust, or "REIT," on August 2, 2012, and commenced operations on September 25, 2012. EARN conducts its business through its wholly owned subsidiaries, EARN OP GP LLC, or the "General Partner," and Ellington Residential Mortgage LP, or the "Operating Partnership," which were formed as a Delaware limited liability company and a Delaware limited partnership, respectively, on July 31, 2012 and commenced operations on September 25, 2012. The Operating Partnership conducts its business of acquiring, investing in, and managing residential mortgage-related and real estate-related assets through its wholly owned subsidiaries. EARN, the General Partner, the Operating Partnership, and their consolidated subsidiaries are hereafter defined as the "Company."

Ellington Residential Mortgage Management LLC, or the "Manager," serves as the Manager of the Company pursuant to the terms of the Fourth Amended and Restated Management Agreement (the "Management Agreement"). The Manager is an affiliate of Ellington Management Group, L.L.C., or "EMG," an investment management firm that is an SEC-registered investment adviser with a 21-year history of investing in a broad spectrum of mortgage-backed securities and related derivatives, with an emphasis on the residential mortgage-backed securities, or "RMBS," market. In accordance with the terms of the Management Agreement and the Services Agreement, the Manager is responsible for administering the Company's business activities and day-to-day operations, and performs certain services, subject to oversight by the Board of Trustees. See Note 9 for further information on the Management Agreement.

The Company acquires and manages RMBS, for which the principal and interest payments are guaranteed by a U.S. government agency or a U.S. government-sponsored entity, or "Agency RMBS," and RMBS that do not carry such guarantees, or "non-Agency RMBS," such as RMBS backed by prime jumbo, Alternative A-paper, manufactured housing, and subprime residential mortgage loans. Agency RMBS include both Agency pools and Agency collateralized mortgage obligations, or "CMOs," and non-Agency RMBS primarily consist of non-Agency CMOs, both investment grade and non-investment grade. The Company may also acquire and manage mortgage servicing rights, residential mortgage loans, and other mortgage- and real estate-related assets. The Company may also invest in other instruments including, but not limited to, forward-settling To-Be-Announced Agency pass-through certificates, or "TBAs," interest rate swaps and swaptions, U.S. Treasury securities, Eurodollar and U.S. Treasury futures, other financial derivatives, and cash equivalents. The Company's targeted investments may range from unrated first loss securities to AAA senior securities.

The Company has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended, or "the Code," and intends to conduct its operations to be qualified and taxed as REIT. As a REIT, the Company is required to distribute annually at least 90% of its taxable income. As long as the Company continues to qualify as a REIT, it will not be subject to U.S. federal corporate taxes on its taxable income to the extent that it distributes all of its annual taxable income to its shareholders. It is the intention of the Company to distribute at least 100% of its taxable income, after application of available tax attributes, within the time limits prescribed by the Code, which may extend into the subsequent taxable year.

2. Significant Accounting Policies

(A) Basis of Presentation: The Company's unaudited interim consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States of America, or "U.S. GAAP." Entities in which the Company has a controlling financial interest, through ownership of the majority of the entities' voting equity interests, or through other contractual rights that give the Company control, are consolidated by the Company. All inter-company balances and transactions have been eliminated. The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and those differences could be material. In management's opinion, all material adjustments, considered necessary for a fair presentation of the Company's interim consolidated financial statements have been included and are only of a normal recurring nature. Interim results are not necessarily indicative of the results that may be expected for the entire fiscal year. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

(B) Valuation: The Company applies ASC 820-10, Fair Value Measurement and Disclosures ("ASC 820-10"), to its holdings of financial instruments. ASC 820-10 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the observability of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1—inputs to the valuation methodology are observable and reflect quoted prices (unadjusted) for identical assets or liabilities in active markets. Currently, the types of financial instruments the Company generally includes in this category are, exchange-traded derivatives;
- Level 2—inputs to the valuation methodology other than quoted prices included in Level 1 are observable for the asset or liability, either directly or indirectly. Currently, the types of financial instruments that the Company generally includes in this category are Agency RMBS, non-Agency RMBS determined to have sufficiently observable market data, U.S. Treasury securities, actively traded derivatives such as TBAs, interest rate swaps, and swaptions; and
- Level 3—inputs to the valuation methodology are unobservable and significant to the fair value measurement. Currently, this category includes RMBS where there is less price transparency.

For certain financial instruments, the various inputs that management uses to measure fair value for such financial instrument may fall into different levels of the fair value hierarchy. In such cases, the determination of which category within the fair value hierarchy is appropriate for such financial instrument is based on the lowest level of input that is significant to the fair value measurement. ASC 820 prioritizes the various inputs that management uses to measure fair value with the highest priority to inputs that are observable and reflect quoted prices (unadjusted) for identical assets or liabilities in active markets (Level 1) and the lowest priority to inputs that are unobservable and significant to the fair value measurement (Level 3). The assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the financial instrument. The Company may use valuation techniques consistent with the market and income approaches to measure the fair value of its assets and liabilities. The market approach uses third-party valuations and information obtained from market transactions involving identical or similar assets or liabilities. The income approach uses projections of the future economic benefits of an instrument to determine its fair value, such as in the discounted cash flow methodology. The inputs or methodology used for valuing financial instruments are not necessarily an indication of the risk associated with investing in these financial instruments. Transfers between levels of the fair value hierarchy are assumed to occur at the end of the reporting period.

Summary Valuation Techniques

For financial instruments that are traded in an "active market," the best measure of fair value is the quoted market price. However, many of the Company's financial instruments are not traded in an active market. Therefore, management generally uses third-party valuations when available. If third-party valuations are not available, management uses other valuation techniques, such as the discounted cash flow methodology. The following are summary descriptions, for the various categories of financial instruments, of the valuation methodologies management uses in determining fair value of the Company's financial instruments in such categories. Management utilizes such methodologies to assign a good faith fair value (the estimated price that, in an orderly transaction at the valuation date, would be received to sell an asset, or paid to transfer a liability, as the case may be) to each such financial instrument.

Valuations for fixed rate RMBS pass-throughs issued by a U.S government agency or government-sponsored enterprise, or "GSE," are typically based on observable pay-up data (pay-ups are price premiums for specified categories of fixed rate pools relative to their TBA counterparts) or models that use observable market data, such as interest rates and historical prepayment speeds, and are validated against third-party valuations. With respect to the Company's other RMBS investments and TBAs, management seeks to obtain at least one third-party valuation, and often obtains multiple valuations when available. Management has been able to obtain third-party valuations on the vast majority of these instruments and expects to continue to solicit third-party valuations in the future. Management generally values each financial instrument at the average of third-party valuations received and not rejected as described below. Third-party valuations are not binding, and while management generally does not adjust the valuations it receives, management may challenge or reject a valuation when, based on its validation criteria, management determines that such valuation is unreasonable or erroneous. Furthermore, based on its validation criteria, management may determine that the average of the third-party valuations received for a given instrument does not result in what management believes to be the fair value of such instrument, and in such circumstances management may override this average with its own good faith valuation. The validation criteria may take into account output from management's own models, recent trading activity in the same or similar instruments, and valuations received from third parties. The use of proprietary models requires the use of a significant amount of judgment and the application of various assumptions including, but not limited to, assumptions concerning future prepayment rates and default rates.

Given their relatively high level of price transparency, Agency RMBS pass-throughs and TBAs are typically designated as Level 2 assets, although Agency interest only and inverse interest only RMBS are currently designated as Level 3 assets since they generally have less price transparency. Non-Agency RMBS are generally classified as either Level 2 or Level 3 based on analysis of available market data such as recent trades and executable bids. Furthermore, the methodology used by the third-party valuation providers is reviewed at least annually by management, so as to ascertain whether such providers are utilizing observable market data to determine the valuations that they provide.

Interest rate swaps and swaptions are typically valued based on internal models that use observable market data, including applicable interest rates in effect as of the measurement date; the model-generated valuations are then typically compared to counterparty valuations for reasonableness. These financial derivatives are generally designated as Level 2 instruments.

In valuing its derivatives, the Company also considers the creditworthiness of both the Company and its counterparties, along with collateral provisions contained in each derivative agreement.

The Company's repurchase and reverse repurchase agreements are carried at cost, which approximates fair value. Repurchase agreements and reverse repurchase agreements are classified as Level 2 assets and liabilities based on the adequacy of the collateral and their short term nature.

The Company's valuation process, including the application of validation criteria, is overseen by the Manager's Valuation Committee. The Valuation Committee includes senior level executives from various departments within the Manager, and each quarter the Valuation Committee reviews and approves the valuations of the Company's investments. The valuation process also includes a monthly review by the Company's third party administrator. The goal of this review is to replicate various aspects of the Company's valuation process based on the Company's documented procedures.

Because of the inherent uncertainty of valuation, the estimated fair value of the Company'