

Invesco Mortgage Capital Inc.  
Form 10-Q  
November 04, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2011

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

**INVESCO MORTGAGE CAPITAL INC.**

(Exact Name of Registrant as Specified in Its Charter)

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**Maryland**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**26-2749336**  
(I.R.S. Employer  
Identification No.)

**1555 Peachtree Street, N.E., Suite 1800**

**Atlanta, Georgia**  
(Address of Principal Executive Offices)

**(404) 892-0896**  
(Registrant's Telephone Number, Including Area Code)

**30309**  
(Zip 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  No

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

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

Large Accelerated Filer  Accelerated filer   
Non-Accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of November 4, 2011, there were 115,390,095 outstanding shares of common stock of Invesco Mortgage Capital Inc.

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**INVESCO MORTGAGE CAPITAL INC.**

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**Table of Contents****PART I****ITEM 1. FINANCIAL STATEMENTS****INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

\$ in thousands, except per share amounts

	As of	
	September 30, 2011 (Unaudited)	December 31, 2010
<b>ASSETS</b>		
Mortgage-backed securities, at fair value	14,336,951	5,578,333
Cash	56,914	63,552
Restricted cash	254,587	101,144
Investment related receivable	430,053	7,601
Investments in unconsolidated ventures, at fair value	110,907	54,725
Accrued interest receivable	55,713	22,503
Derivative assets, at fair value	1,580	33,255
Other assets	1,812	1,287
<b>Total assets</b>	<b>15,248,517</b>	<b>5,862,400</b>
<b>LIABILITIES AND EQUITY</b>		
<b>Liabilities:</b>		
Repurchase agreements	12,181,845	4,344,659
Derivative liability, at fair value	388,886	37,850
Dividends and distributions payable	93,449	49,741
Investment related payable	640,766	372,285
Accrued interest payable	10,780	2,579
Accounts payable and accrued expenses	916	1,065
Due to affiliate	8,092	3,407
<b>Total liabilities</b>	<b>13,324,734</b>	<b>4,811,586</b>
<b>Equity:</b>		
Preferred Stock: par value \$0.01 per share; 50,000,000 shares authorized, 0 shares issued and outstanding		
Common Stock: par value \$0.01 per share; 450,000,000 shares authorized, 115,387,548 and 49,854,196 shares issued and outstanding, at September 30, 2011 and December 31, 2010, respectively	1,154	499
Additional paid in capital	2,299,309	1,002,809
Accumulated other comprehensive income (loss)	(386,187)	24,015
Distributions in excess of earnings	(15,648)	(8,173)
<b>Total shareholders' equity</b>	<b>1,898,628</b>	<b>1,019,150</b>
Non-controlling interest	25,155	31,664
<b>Total equity</b>	<b>1,923,783</b>	<b>1,050,814</b>
<b>Total liabilities and equity</b>	<b>15,248,517</b>	<b>5,862,400</b>

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

**Table of Contents****INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

<b>\$ in thousands, except per share data</b>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Revenues</b>				
Interest income	138,291	36,067	315,808	83,284
Interest expense	50,452	8,873	100,237	18,904
<b>Net interest income</b>	<b>87,839</b>	<b>27,194</b>	<b>215,571</b>	<b>64,380</b>
<b>Other income</b>				
Gain (loss) on sale of investments	3,637	(311)	8,442	1,064
Equity in earnings (loss) and fair value change in unconsolidated ventures	(993)	3,793	2,738	5,888
Loss on other-than-temporarily impaired securities		(124)		(510)
Unrealized loss on interest rate swaps	(453)	(9)	(655)	(44)
Realized and unrealized credit default swap income	858		4,649	
<b>Total other income</b>	<b>3,049</b>	<b>3,349</b>	<b>15,174</b>	<b>6,398</b>
<b>Expenses</b>				
Management fee related party	7,884	2,039	17,612	5,094
General and administrative	829	885	2,855	2,839
<b>Total expenses</b>	<b>8,713</b>	<b>2,924</b>	<b>20,467</b>	<b>7,933</b>
Net income	82,175	27,619	210,278	62,845
Net income attributable to non-controlling interest	1,091	1,433	3,948	3,860
Net income attributable to common shareholders	81,084	26,186	206,330	58,985
<b>Earnings per share:</b>				
Net income attributable to common shareholders (basic/diluted)	0.79	1.01	2.70	2.74
Dividends declared per common share	0.80	1.00	2.77	2.52
<b>Weighted average number of shares of common stock:</b>				
Basic	103,028	26,047	76,311	21,552
Diluted	104,472	27,478	77,750	22,981

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



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## INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF EQUITY

For the nine months ended September 30, 2011

(Unaudited)

\$ in thousands, except per share amounts	Common Stock		Attributable to Common Shareholders			Total Shareholders Equity	Non-Controlling Interest	Total Equity	Comprehensive Income (Loss)
	Shares	Amount	Additional Paid in Capital	Accumulated Other Comprehensive Income (loss)	Distributions in excess of earnings				
<b>Balance at January 1, 2011</b>	49,854,196	499	1,002,809	24,015	(8,173)	1,019,150	31,664	1,050,814	
Net income					206,330	206,330	3,948	210,278	210,278
Comprehensive income									
Change in net unrealized gains and losses on available for sale securities				(33,016)		(33,016)	(62)	(33,078)	(33,078)
Change in net unrealized gains and losses on derivatives				(377,186)		(377,186)	(6,450)	(383,636)	(383,636)
Total comprehensive income									(206,436)
Net proceeds from issuance of common stock, net of offering costs	65,527,839	655	1,296,364			1,297,019		1,297,019	
Stock awards	5,513								
Common stock dividends					(213,805)	(213,805)		(213,805)	
Common unit dividends							(3,947)	(3,947)	
Amortization of equity-based compensation			136			136	2	138	
<b>Balance at September 30, 2011</b>	115,387,548	1,154	2,299,309	(386,187)	(15,648)	1,898,628	25,155	1,923,783	

The accompanying notes are an integral part of this consolidated financial statement.



**Table of Contents****INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

\$ in thousands	Nine Months Ended September 30,	
	2011	2010
<b>Cash Flows from Operating Activities</b>		
Net income	210,278	62,845
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of mortgage-backed securities premiums and discounts, net	25,195	(9,827)
Unrealized loss on interest swap	655	44
Unrealized gain on credit default swap	(1,580)	
Gain on sale of mortgage-backed securities	(8,442)	(1,064)
Loss on other-than-temporarily impaired securities		510
Equity in earnings and fair value change in unconsolidated limited partnerships	(2,738)	(5,888)
Amortization of equity-based compensation	138	85
Changes in operating assets and liabilities		
Increase in accrued interest	(33,210)	(7,432)
(Increase) decrease in other assets	(525)	330
Increase in accrued interest payable	8,201	1,003
Increase in due to affiliate	4,685	1,385
(Decrease) increase in accounts payable and accrued expenses	(208)	570
<b>Net cash provided by operating activities</b>	<b>202,449</b>	<b>42,561</b>
<b>Cash Flows from Investing Activities</b>		
Purchase of mortgage-backed securities	(10,720,992)	(2,022,403)
Contributions to Investment in PPIP, net	(52,013)	(50,890)
Principal payments from mortgage-backed securities	936,444	265,904
Proceeds from sale of mortgage-backed securities	1,180,416	216,104
<b>Net cash used in investing activities</b>	<b>(8,656,145)</b>	<b>(1,591,285)</b>
<b>Cash Flows from Financing Activities</b>		
Proceeds from issuance of common stock	1,297,079	341,986
Restricted cash	(144,615)	(25,802)
Proceeds from repurchase agreements	63,074,773	11,092,883
Principal repayments of repurchase agreements	(55,606,134)	(9,889,889)
Proceeds from TALF financing		71,525
Principal payments of TALF financing		(146)
Payments of dividends and distributions	(174,045)	(45,480)
<b>Net cash provided by financing activities</b>	<b>8,447,058</b>	<b>1,545,077</b>
<b>Net change in cash</b>	<b>(6,638)</b>	<b>(3,647)</b>
Cash, beginning of period	63,552	24,041
<b>Cash, end of period</b>	<b>56,914</b>	<b>20,394</b>

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### Supplement disclosure of cash flow information

Interest paid	92,036	17,831
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### Non-cash investing and financing activities information

Net change in unrealized gain on available-for-sale securities and derivatives	(416,714)	3,834
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Net change in investment in PPIP	(1,431)	384
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Net change in restricted cash	(8,828)	
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Dividends and distributions declared not paid	43,708	27,473
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Payable for mortgage-backed securities purchased	(204,317)	57,016
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Repurchase agreements, not settled	368,547	
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The accompanying notes are an integral part of these consolidated financial statements.

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**INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**Note 1 Organization and Business Operations**

Invesco Mortgage Capital Inc. (the Company) is a Maryland corporation focused on investing in, financing and managing residential and commercial mortgage-backed securities and mortgage loans. The Company invests in residential mortgage-backed securities (RMBS) for which a U.S. Government Agency such as the Government National Mortgage Association (Ginnie Mae), the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) guarantees payments of principal and interest on the securities (collectively Agency RMBS). The Company's Agency RMBS investments include mortgage pass-through securities and collateralized mortgage obligations (CMOs). The Company also invests in RMBS that are not issued or guaranteed by a U.S. government Agency (non-Agency RMBS), commercial mortgage-backed securities (CMBS), and residential and commercial mortgage loans. The Company is externally managed and advised by Invesco Advisers, Inc. (the Manager), a registered investment adviser and an indirect, wholly-owned subsidiary of Invesco Ltd. (Invesco), a global investment management company.

The Company conducts its business through IAS Operating Partnership LP (the Operating Partnership) as its sole general partner. As of September 30, 2011, the Company owned 98.8% of the Operating Partnership and Invesco Investments (Bermuda) Ltd., a direct, wholly-owned subsidiary of Invesco, owned the remaining 1.2%.

The Company finances its Agency RMBS, non-Agency RMBS and CMBS investments through short-term borrowings structured as repurchase agreements. The Manager has secured commitments for the Company with a number of repurchase agreement counterparties. In addition, the Company had financed its CMBS portfolio with financings under the U.S. government's Term Asset-Backed Securities Loan Facility (TALF) which were repaid and replaced with repurchase agreements during 2010. The Company has also financed its investments in certain non-Agency RMBS, CMBS and residential and commercial mortgage loans by contributing capital to a partnership that invests in the public private investments funds (the PPIF) managed by the Company's Manager. In addition, the Company may use other sources of financing including committed borrowing facilities and other private financing.

The Company 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, as amended (Code), commencing with the Company's taxable year ended December 31, 2009. To maintain the Company's REIT qualification, the Company is generally required to distribute at least 90% of its taxable income to its shareholders annually.

**Note 2 Summary of Significant Accounting Policies**

**Basis of Quarterly Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial position and the results of operations of the Company for the interim periods presented have been included. Certain disclosures included in the Company's annual report are not required to be included on an interim basis in the company's quarterly reports on Forms 10-Q. The Company has condensed or omitted these disclosures. The interim consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and related notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2010 which was filed with the Securities and Exchange Commission (the SEC) on March 14, 2011. The results of operations for the period ended September 30, 2011 are not necessarily indicative of the results to be expected for the full year or any other future period.

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### **Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated.

### **Use of Estimates**

The accounting and reporting policies of the Company conform to U.S. GAAP. The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Examples of estimates include, but are not limited to, estimates of the fair values of financial instruments, interest income on mortgage-backed securities ( MBS ) and other-than-temporary impairment charges. Actual results may differ from those estimates.

### **Cash and Cash Equivalents**

The Company considers all highly liquid investments that have original or remaining maturity dates of three months or less when purchased to be cash equivalents. At September 30, 2011, the Company had cash and cash equivalents, including amounts restricted, in excess of the Federal Deposit Insurance Corporation, or FDIC, deposit insurance limit of \$250,000 per institution. The Company mitigates its risk of loss by placing cash and cash equivalents with numerous major financial institutions.

### **Deferred Offering Costs**

The Company records costs associated with stock offerings as a reduction in additional paid in capital. The Company includes deferred offering costs in other assets.

### **Underwriting Commissions and Costs**

Underwriting commissions and direct costs incurred in connection with the Company's initial public offering ( IPO ) and subsequent follow-on common stock offerings are reflected as a reduction of additional paid-in-capital.

### **Repurchase Agreements**

The Company finances its Agency RMBS, non-Agency RMBS and its CMBS investment portfolio through the use of repurchase agreements. Repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements.

In instances where the Company acquires Agency RMBS, non-Agency RMBS or CMBS through repurchase agreements with the same counterparty from whom the Agency RMBS, non-Agency RMBS or CMBS were purchased, the Company accounts for the purchase commitment and repurchase agreement on a net basis and records a forward commitment to purchase Agency RMBS, non-Agency RMBS or CMBS as a derivative instrument if the transaction does not comply with the criteria for gross presentation. All of the following criteria must be met for gross presentation in the circumstance where the repurchase assets are financed with the same counterparty:

the initial transfer of and repurchase financing cannot be contractually contingent;

the repurchase financing entered into between the parties provides full recourse to the transferee and the repurchase price is fixed;

the financial asset has an active market and the transfer is executed at market rates; and

the repurchase agreement and financial asset do not mature simultaneously.

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If the transaction complies with the criteria for gross presentation, the Company records the assets and the related financing on a gross basis on its balance sheet, and the corresponding interest income and interest expense in its statements of operations. Such forward commitments are recorded at fair value with subsequent changes in fair value recognized in income. Additionally, the Company records the cash portion of its investment in Agency RMBS and non-Agency RMBS as a mortgage related receivable from the counterparty on its balance sheet.

For assets representing available-for-sale investment securities any change in fair value is reported through consolidated other comprehensive income (loss) with the exception of impairment losses, which are recorded in the consolidated statement of operations.

## **Fair Value Measurements**

In January 2010, the FASB updated guidance entitled, *Improving Disclosures about Fair Value Measurements*. The guidance required a number of additional disclosures regarding fair value measurements. Specifically, entities should disclose: (1) the amount of significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for these transfers; (2) the reasons for any transfers in or out of Level 3; and (3) information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements on a gross basis. Except for the requirement to disclose information about purchases, sales, issuances, and settlements in the reconciliation of recurring Level 3 measurements on a gross basis, all the amendments are effective for interim and annual reporting periods beginning after December 15, 2009. The Company adopted these provisions in preparing its Consolidated Financial Statements for the period ended March 31, 2010. The adoption of these provisions only affected the disclosure requirements for fair value measurements and as a result had no impact on the Company's consolidated statements of operations and consolidated balance sheets.

The Company discloses the fair value of its financial instruments according to a fair value hierarchy (Levels 1, 2, and 3, as defined). In accordance with U.S. GAAP, the Company is required to provide enhanced disclosures regarding instruments in the Level 3 category (which require significant management judgment), including a separate reconciliation of the beginning and ending balances for each major category of assets and liabilities.

Additionally, U.S. GAAP permits entities to choose to measure many financial instruments and certain other items at fair value (the fair value option). Unrealized gains and losses on items for which the fair value option has been elected are irrevocably recognized in earnings at each subsequent reporting date.

During 2009 and 2011, the Company elected the fair value option for its investments in unconsolidated ventures. The Company has the one-time option to elect fair value for these financial assets on the election date. The changes in the fair value of these instruments are recorded in equity in earnings and fair value change in unconsolidated ventures in the consolidated statements of operations.

## **Securities**

The Company designates securities as held-to-maturity, available-for-sale, or trading depending on its ability and intent to hold such securities to maturity. Trading and securities available-for-sale are reported at fair value, while securities held-to-maturity are reported at amortized cost. Although the Company generally intends to hold most of its RMBS and CMBS until maturity, the Company may, from time to time, sell any of its RMBS or CMBS as part of its overall management of its investment portfolio and as such will classify its RMBS and CMBS as available-for-sale securities.

All securities classified as available-for-sale are reported at fair value, based on market prices from third-party sources, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity. When applicable, included with available-for-sale securities are forward purchase commitments on to be announced securities (TBA). The Company records TBA purchases on the trade date and the corresponding payable is recorded as an outstanding liability as a payable for investments purchased until the settlement date of the transaction. This is presented in the Investment related payable line item on the consolidated balance sheet.

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The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. The determination of whether a security is other-than-temporarily impaired involves judgments and assumptions based on subjective and objective factors. Consideration is given to (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of recovery, in fair value of the security, and (iii) the Company's intent and ability to retain its investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value.

For debt securities, the amount of the other-than-temporary impairment related to a credit loss or impairments on securities that the Company has the intent or for which it is more likely than not that the Company will need to sell before recovery are recognized in earnings and reflected as a reduction in the cost basis of the security. The amount of the other-than-temporary impairment on debt securities related to other factors is recorded consistent with changes in the fair value of all other available-for-sale securities as a component of consolidated shareholders' equity in other comprehensive income or loss with no change to the cost basis of the security.

### **Interest Income Recognition**

Interest income on available-for-sale MBS, which includes accretion of discounts and amortization of premiums on such MBS, is recognized over the life of the investment using the effective interest method. Management estimates, at the time of purchase, the future expected cash flows and determines the effective interest rate based on these estimated cash flows and the Company's purchase price. As needed, these estimated cash flows are updated and a revised yield is computed based on the current amortized cost of the investment. In estimating these cash flows, there are a number of assumptions subject to uncertainties and contingencies, including the rate and timing of principal payments (prepayments, repurchases, defaults and liquidations), the pass through or coupon rate and interest rate fluctuations. In addition, management must use its judgment to estimate interest payment shortfalls due to delinquencies on the underlying mortgage loans. These uncertainties and contingencies are difficult to predict and are subject to future events that may impact management's estimates and its interest income. Security transactions are recorded on the trade date. Realized gains and losses from security transactions are determined based upon the specific identification method and recorded as gain (loss) on sale of available-for-sale securities in the consolidated statement of operations.

### **Investments in Unconsolidated Ventures**

The Company has investments in unconsolidated ventures. In circumstances where the Company has a non-controlling interest but is deemed to be able to exert significant influence over the affairs of the enterprise the Company utilizes 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.

The Company elected the fair value option for its investments in unconsolidated ventures. The election for investments in unconsolidated ventures was made upon their initial recognition in the financial statements. The Company has elected the fair value option for the investments in unconsolidated ventures for the purpose of enhancing the transparency of its financial condition.

The Company measures the fair value of the investments in unconsolidated ventures on the basis of the net asset value per share of the investments as permitted in guidance effective for the interim and annual periods ended after December 15, 2009.

### **Dividends and Distributions Payable**

Dividends and distributions payable represent dividends declared at the balance sheet date which are payable to common shareholders and distributions declared at the balance sheet date which are payable to non-controlling interest common unit holders of the Operating Partnership, respectively.

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### **Earnings per Share**

The Company calculates basic earnings per share by dividing net income for the period by weighted-average shares of the Company's common stock outstanding for that period. Diluted income per share takes into account the effect of dilutive instruments, such as units of limited partnership interest in the Operating Partnership ( OP Units ), and unvested restricted stock, but uses the average share price for the period in determining the number of incremental shares that are to be added to the weighted-average number of shares outstanding.

### **Comprehensive Income**

Comprehensive income is comprised of net income, as presented in the consolidated statements of operations, adjusted for changes in unrealized gains or losses on available for sale securities and changes in the fair value of derivatives accounted for as cash flow hedges.

### **Accounting for Derivative Financial Instruments**

U.S. GAAP provides disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for; and (iii) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. U.S. GAAP requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts, such as credit default swaps, that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting under U.S. GAAP.

### **Income Taxes**

The Company elected to be taxed as a REIT, commencing with the Company's taxable year ended December 31, 2009. Accordingly, the Company will generally not be subject to U.S. federal and applicable state and local corporate income tax to the extent that the Company makes qualifying distributions to its shareholders, and provided the Company satisfies on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. If the Company fails to qualify as a REIT, and does not qualify for certain statutory relief provisions, it will be subject to U.S. federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which the Company lost its REIT qualification. Accordingly, the Company's failure to qualify as a REIT could have a material adverse impact on its results of operations and amounts available for distribution to its shareholders.

A REIT's dividend paid deduction for qualifying dividends to the Company's shareholders is computed using its taxable income as opposed to net income reported on the consolidated financial statements. Taxable income, generally, will differ from net income reported on the consolidated financial statements because the determination of taxable income is based on tax regulations and not financial accounting principles.



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The Company may elect to treat certain of its future subsidiaries as taxable REIT subsidiaries ( TRS ). In general, a TRS may hold assets and engage in activities that the Company cannot hold or engage in directly and generally may engage in any real estate or non-real estate-related business. A TRS is subject to U.S. federal, state and local corporate income taxes.

While a TRS will generate net income, a TRS can declare dividends to the Company which will be included in its taxable income and necessitate a distribution to its shareholders. Conversely, if the Company retains earnings at a TRS level, no distribution is required and the Company can increase book equity of the consolidated entity. The Company has no adjustments regarding its tax accounting treatment of any uncertainties. The Company expects to recognize interest and penalties related to uncertain tax positions, if any, as income tax expense, which will be included in general and administrative expense.

## **Share-Based Compensation**

The Company has adopted an equity incentive plan under which its independent directors, as part of their compensation for serving as directors, are eligible to receive quarterly restricted stock awards. In addition, the Company may compensate the officers and employees of the Manager under this plan pursuant to the management agreement.

Share-based compensation arrangements include share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Compensation costs relating to share-based payment transactions are recognized in the consolidated financial statements, based on the fair value of the equity or liability instruments issued on the date of grant, for awards to the Company's independent directors. Compensation related to stock awards to officers and employees of the Manager are recorded at the estimated fair value of the award during the vesting period. The Company makes an upward or downward adjustment to compensation expense for the difference in the fair value at the date of grant and the date the award was earned.

## **Dividend Reinvestment Plan**

The Company has implemented a dividend reinvestment and stock purchase plan (the Plan ). Under the terms of the Plan, shareholders who participate in the Plan may purchase shares of common stock directly from the Company. Plan participants may also automatically reinvest all or a portion of their dividends for additional shares of stock.

## **Reclassifications**

The presentation of certain prior period reported amounts has been reclassified to be consistent with the current presentation. Such reclassifications had no impact on net income or equity attributable to common shareholders.

## **Note 3 Mortgage-Backed Securities**

All of the Company's MBS are classified as available-for-sale and, as such, are reported at fair value, which is determined by obtaining valuations from an independent source. If the fair value of a security is not available from a dealer or third-party pricing service, or such data appears unreliable, the Company may estimate the fair value of the security using a variety of methods including other pricing services, repurchase agreement pricing, discounted cash flow analysis, matrix pricing, option adjusted spread models and other fundamental analysis of observable market factors. At September 30, 2011, all of the Company's MBS values were based on values obtained from third-party pricing services. The following tables present certain information about the Company's investment portfolio at September 30, 2011 and December 31, 2010.

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September 30, 2011

	00,000,000,	00,000,000,	00,000,000,	00,000,000,	00,000,000,	00,000,000,	00,000,000,
						Net	
		Unamortized		Unrealized		Weighted	
\$ in thousands	Principal	Premium	Amortized	Gain/	Fair	Average	Average
	Balance	(Discount)	Cost	(Loss)	Value	Coupon <sup>(1)</sup>	Yield <sup>(2)</sup>
Agency RMBS:							
15 year fixed-rate	2,360,188	128,782	2,488,970	43,399	2,532,369	4.33%	3.13%
30 year fixed-rate	5,701,102	400,866	6,101,968	110,900	6,212,868	5.17%	3.94%
ARM	92,785	1,850	94,635	2,087	96,722	3.53%	3.14%
Hybrid ARM	1,267,544	28,045	1,295,589	23,359	1,318,948	3.31%	2.81%
Total Agency	9,421,619	559,543	9,981,162	179,745	10,160,907	4.69%	3.59%
MBS-CMO	629,502	(487,871)	141,631	1,769	143,400	3.30%	6.24%
Non-Agency RMBS <sup>(3)</sup>	3,061,712	(316,705)	2,745,007	(79,399)	2,665,608	5.84%	6.39%
CMBS	1,492,384	(21,422)	1,470,962	(103,926)	1,367,036	5.48%	5.66%
Total	14,605,217	(266,455)	14,338,762	(1,811)	14,336,951	4.70%	4.11%

(1) Net weighted average coupon ( WAC ) is presented net of servicing and other fees.

(2) Average yield incorporates future prepayment and loss assumptions.

(3) The non-Agency RMBS held by the Company is 84.3% fixed rate and 15.7% floating rate, based on fair value.

December 31, 2010

	00,000,000	00,000,000	00,000,000	00,000,000	00,000,000	00,000,000	00,000,000
						Net	
		Unamortized		Unrealized		Weighted	
\$ in thousands	Principal	Premium	Amortized	Gain/	Fair	Average	Average
	Balance	(Discount)	Cost	(Loss)	Value	Coupon <sup>(1)</sup>	Yield <sup>(2)</sup>
Agency RMBS:							
15 year fixed-rate	1,789,891	99,611	1,889,502	(8,688)	1,880,814	4.49%	2.89%
30 year fixed-rate	2,059,475	163,332	2,222,807	6,771	2,229,578	5.54%	3.57%
ARM	21,926	1,080	23,006	(494)	22,512	4.23%	2.55%
Hybrid ARM	70,253	1,612	71,865	448	72,313	3.68%	2.71%
Total Agency	3,941,545	265,635	4,207,180	(1,963)	4,205,217	5.03%	3.25%
MBS-CMO	57,232	(30,248)	26,984	1,821	28,805	4.92%	3.59%
Non-Agency RMBS <sup>(3)</sup>	1,168,797	(339,501)	829,296	17,072	846,368	4.83%	5.47%
CMBS	488,246	(4,640)	483,606	14,337	497,943	5.35%	5.51%
Total	5,655,820	(108,754)	5,547,066	31,267	5,578,333	5.01%	3.78%

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- (1) Net weighted average coupon ( WAC ) is presented net of servicing and other fees.  
 (2) Average yield incorporates future prepayment and loss assumptions.  
 (3) The non-Agency RMBS held by the Company is 75.8% fixed rate and 24.2% floating rate, based on fair value.  
 The components of the carrying value of the Company's investment portfolio at September 30, 2011 and December 31, 2010 are presented below.

<b>\$ in thousands</b>	<b>September 30, 2011</b>	<b>December 31, 2010</b>
Principal balance	14,605,217	5,655,820
Unamortized premium	589,517	271,728
Unamortized discount	(855,972)	(380,482)
Gross unrealized gains	221,213	75,231
Gross unrealized losses	(223,024)	(43,964)
 Fair value	 14,336,951	 5,578,333

The following table summarizes certain characteristics of the Company's investment portfolio, at fair value, according to estimated weighted average life classifications as of September 30, 2011 and December 31, 2010:

<b>\$ in thousands</b>	<b>September 30, 2011</b>	<b>December 31, 2010</b>
Less than one year	82,942	26,214
Greater than one year and less than five years	12,098,705	3,304,668
Greater than or equal to five years	2,155,304	2,247,451
 Total	 14,336,951	 5,578,333

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The following tables present the gross unrealized losses and estimated fair value of the Company's MBS by length of time that such securities have been in a continuous unrealized loss position at September 30, 2011 and December 31, 2010, respectively:

September 30, 2011	Fair Value	Fair Value	Fair Value	Fair Value	Fair Value	Fair Value
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>\$ in thousands</b>						
Agency RMBS:						
15 year fixed-rate	295,092	(1,179)			295,092	(1,179)
30 year fixed-rate	796,362	(5,540)			796,362	(5,540)
ARM	13,363	(85)	7,126	(198)	20,489	(283)
Hybrid ARM	50,825	(259)			50,825	(259)
Total Agency	1,155,642	(7,063)	7,126	(198)	1,162,768	(7,261)
MBS-CMO	42,091	(2,894)			42,091	(2,894)
Non-Agency RMBS	2,264,648	(89,337)	36,000	(5,879)	2,300,648	(95,216)
CMBS	1,083,808	(117,653)			1,083,808	(117,653)
Total	4,546,189	(216,947)	43,126	(6,077)	4,589,315	(223,024)

December 31, 2010	Fair Value	Fair Value	Fair Value	Fair Value	Fair Value	Fair Value
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>\$ in thousands</b>						
Agency RMBS:						
15 year fixed-rate	1,039,444	(17,284)			1,039,444	(17,284)
30 year fixed-rate	802,118	(10,885)			802,118	(10,885)
ARM	14,911	(251)	7,601	(244)	22,512	(495)
Hybrid ARM	10,912	(17)			10,912	(17)
Total Agency	1,867,385	(28,437)	7,601	(244)	1,874,986	(28,681)
MBS-CMO						
Non-Agency RMBS	370,839	(13,242)			370,839	(13,242)
CMBS	138,037	(2,041)			138,037	(2,041)
Total	2,376,261	(43,720)	7,601	(244)	2,383,862	(43,964)

Gross unrealized losses on the Company's Agency RMBS were \$7.3 million at September 30, 2011. Due to the inherent credit quality of Agency RMBS, the Company determined that at September 30, 2011, any unrealized losses on its Agency RMBS portfolio were temporary.

Gross unrealized losses on the Company's MBS-CMO, non-Agency RMBS, and CMBS were \$215.8 million at September 30, 2011. The Company does not consider these unrealized losses to be credit related, but rather due to non-credit related factors such as interest rates spreads, prepayment speeds, and market fluctuations. These investment securities are included in the Company's assessment for other-than-temporary impairment on at least a quarterly basis.

The following table presents the impact of the Company's MBS on its accumulated other comprehensive income for the three and nine months ended September 30, 2011 and 2010.

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	Three Months ended September 30, 2011	Three Months ended September 30, 2010	Nine Months ended September 30, 2011	Nine Months ended September 30, 2010
<b>\$ in thousands</b>				
Accumulated other comprehensive income from investment securities:				
Unrealized gain on MBS at beginning of period	32,110	33,921	31,267	12,741
Unrealized gain (loss) on MBS	(33,921)	25,093	(33,078)	46,273
Balance at the end of period	(1,811)	59,014	(1,811)	59,014

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During the three months ended September 30, 2011, the Company reclassified \$3.1 million of net unrealized gains from other comprehensive income into gain on sale of investments as a result of the Company selling certain investments.

During the nine months ended September 30, 2011, the Company reclassified \$11.2 million of net unrealized gains from other comprehensive income into gain on sale of investments as a result of the Company selling certain investments.

The Company assesses its investment securities for other-than-temporary impairment on at least 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. In deciding on whether or not a security is other than temporarily impaired, the Company considers several factors, including the nature of the investment, communications from the trustees of securitizations regarding the credit quality of the security, the severity and duration of the impairment, the cause of the impairment, and the Company's intent that it is more likely than not that the Company can hold the security until recovery of its cost basis.

The following table presents the other-than-temporary impairments for the three and nine months ended September 30, 2011 and 2010.

	Three Months ended September 30, 2011	Three Months ended September 30, 2010	Nine Months ended September 30, 2011	Nine Months ended September 30, 2010
<b>\$ in thousands</b>				
Credit related other-than-temporary impairments included in earnings		124		510
Non-credit related other-than-temporary impairments recognized in other comprehensive income				
<b>Total other-than-temporary impairment losses</b>		124		510

The following table presents a roll-forward of the credit loss component of other-than-temporary impairments for the three and nine months ended September 30, 2011 and 2010.

	Three Months ended September 30, 2011	Three Months ended September 30, 2010	Nine Months ended September 30, 2011	Nine Months ended September 30, 2010
<b>\$ in thousands</b>				
Cumulative credit loss amount at the beginning of the period	510	386	510	
Additions for credit losses for which other-than-temporary impairment had not been previously recognized		124		510
<b>Cumulative credit loss amount at end of period</b>	510	510	510	510

The following table presents components of interest income on the Company's Agency and non-Agency portfolio for the three and nine months ended September 30, 2011 and 2010.

	00,000	00,000	00,000
	<b>Coupon Interest</b>	<b>Net (Premium Amortization)/Discount Accretion</b>	<b>Interest Income</b>
<b>For the three months ended September 30, 2011</b>			
<b>\$ in thousands</b>			
Agency	102,444	(24,229)	78,215
Non-Agency	31,312	10,193	41,505

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CMBS	18,634	(8)	18,626
Other	(55)		(55)
Total	152,335	(14,044)	138,291

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	00,000	00,000	00,000
For the nine months ended September 30, 2011		Net (Premium	
\$ in thousands	Coupon	Amortization)/Discount	Interest
	Interest	Accretion	Income
Agency	232,756	(54,358)	178,398
Non-Agency	72,270	29,125	101,395
CMBS	36,012	38	36,050
Other	(35)		(35)
<b>Total</b>	<b>341,003</b>	<b>(25,195)</b>	<b>315,808</b>

	00,000	00,000	00,000
For the three months ended September 30, 2010		Net (Premium	
\$ in thousands	Coupon	Amortization)/Discount	Interest
	Interest	Accretion	Income
Agency	17,330	(4,304)	13,026
Non-Agency	11,868	8,637	20,505
CMBS	2,458	69	2,527
Other	9		9
<b>Total</b>	<b>31,665</b>	<b>4,402</b>	<b>36,067</b>

		Net (Premium	
For the nine months ended September 30, 2010		Amortization)/Discount	
\$ in thousands	Coupon	Accretion	Interest
	Interest		Income
Agency	41,328	(12,518)	28,810
Non-Agency	25,049	22,106	47,155
CMBS	7,059	239	7,298
Other	21		21
<b>Total</b>	<b>73,457</b>	<b>9,827</b>	<b>83,284</b>

**Note 4 Investments in Unconsolidated Ventures****Invesco Mortgage Recovery Feeder Fund, L.P. and Invesco Mortgage Recovery Loans AIV, L.P.**

The Company invested in certain non-Agency RMBS, CMBS and residential and commercial mortgage loans by contributing equity capital to a legacy securities PPIF managed by the Manager, Invesco Mortgage Recovery Feeder Fund, L.P. (the "Invesco PPIF Fund") that receives financing under the U.S. government's Public Private Investment Program ("PPII"). In addition, the Manager identified a whole loan transaction for the Company, which resulted in the Company's admission into an alternative investment vehicle, the Invesco Mortgage Recovery Loans AIV, L.P. ("AIV"). The Company's initial commitment in the Invesco PPIF Fund and AIV was \$25.0 million. During 2009 and 2010, the Invesco PPIF Fund and AIV accepted additional subscriptions and the Company increased its overall commitment to \$100.0 million which effectively increased the Company's initial ownership interest in the Invesco PPIF Fund and AIV. As of March 31, 2010, the Invesco PPIF Fund stopped accepting investment subscriptions and was deemed closed. The Company made its first contributions to the Invesco PPIF Fund in October 2009. The Company is committed to fund approximately \$4.7 million in aggregate of additional capital at September 30, 2011 for the Invesco PPIF Fund and AIV. The Company realized approximately \$823,000 and \$6.4 million of equity in earnings for the three and nine months ended September 30, 2011 and \$2.0 million and \$3.8 million for the three and nine months ended September 30, 2010. The Company also realized \$1.8 million and \$3.7 million of unrealized loss from these investments for the three and nine months ended September 30, 2011, respectively, and \$1.8 million and \$2.1 million of unrealized appreciation for the three and nine months ended September 30, 2010, respectively.

The Company's non-controlling, unconsolidated ownership interests in these entities are accounted for under the equity method. Capital contributions, distributions, profits and losses of the Invesco PPIF Fund and AIV are allocated in accordance with the terms of the entities limited partnership agreements. Such allocations may differ from the stated percentage interests, if any, as a result of preferred returns and



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allocation formulas as described in such agreements. The Company has made the fair value election for its investment in both unconsolidated ventures. The fair value measurement for the investment in unconsolidated ventures is based on the net asset value per share of the investment, or its equivalent.

**Table of Contents****IMRF Loan Portfolio Member LLC**

On September 30, 2011, the Company invested in a portfolio of commercial mortgage loans by contributing \$40 million of equity capital to IMRF Loan Portfolio Member LLC ( IMRF ), a limited partnership managed by AIV. IMRF acquired the mortgage portfolio on the same day. The Company has fully funded its commitment to IMRF. The Company recognized no income or loss in respect of its ownership interests in IMRF for the three months ended September 30, 2011.

The Company's non-controlling, unconsolidated ownership interest in IMRF is accounted for under the equity method. Capital contributions, distributions, profits and losses of IMRF are allocated in accordance with the terms of the entity's operating agreement. Such allocations may differ from the stated percentage interests, if any, as a result of preferred returns and allocation formulas as described in the agreement. The Company has made the fair value election for its investment in IMRF. The fair value measurement for the investment in unconsolidated limited liability companies is based on the net asset value per share of the investment, or its equivalent.

**Note 5 Borrowings****Repurchase Agreements**

The Company has entered into repurchase agreements to finance the majority of its portfolio of investments. The repurchase agreements bear interest at a contractually agreed rate. The repurchase obligations mature and typically reinvest every thirty days to one year and have a weighted average aggregate interest rate of 0.60% and 0.57% at September 30, 2011 and December 31, 2010, respectively. During the second quarter of 2010, the Company entered into a repurchase agreement with a one year maturity. The facility was subsequently amended and expires in April 2012. These repurchase agreements are being accounted for as secured borrowings since the Company maintains effective control of the financed assets. The following table summarizes certain characteristics of the Company's repurchase agreements at September 30, 2011 and December 31, 2010:

\$ in thousands	September 30, 2011		December 31, 2010	
	Amount Outstanding	Weighted Average Interest Rate	Amount Outstanding	Weighted Average Interest Rate
Agency RMBS	9,044,073	0.29%	3,483,440	0.33%
Non-Agency RBS	2,114,019	1.51%	459,979	1.76%
CMBS	1,023,753	1.44%	401,240	1.30%
Total	12,181,845	0.60%	4,344,659	0.57%

Under the repurchase agreements, the respective lender retains the right to mark the underlying collateral to fair value. A reduction in the value of pledged assets would require the Company to provide additional collateral or fund margin calls. In addition, the repurchase agreements are subject to certain financial covenants. The Company is in compliance with these covenants at September 30, 2011.

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The following tables summarize certain characteristics of the Company's repurchase agreements at September 30, 2011 and December 31, 2010:

	0,000,000000	0,000,000000	0,000,000000
<b>September 30, 2011</b>			
<b>\$ in thousands</b>			
	<b>Amount</b>	<b>Percent of Total</b>	<b>Company MBS</b>
<b>Repurchase Agreement Counterparties</b>	<b>Outstanding</b>	<b>Amount Outstanding</b>	<b>Held as Collateral</b>
Credit Suisse Securities (USA) LLC	1,890,903	15.6%	2,150,849
Nomura Securities International, Inc.	1,053,730	8.8%	1,121,073
South Street Securities LLC	806,376	6.6%	843,063
Morgan Stanley & Co. Incorporated	770,108	6.3%	817,329
JP Morgan Securities Inc.	717,926	5.9%	806,086
RBS Securities Inc.	716,336	5.9%	806,244
Goldman, Sachs & Co.	661,223	5.4%	703,328
Wells Fargo Securities, LLC	622,058	5.1%	679,397
Industrial and Commercial Bank of China Financial Services LLC	562,799	4.6%	592,198
Mitsubishi UFJ Securities (USA), Inc.	550,717	4.5%	578,523
Deutsche Bank Securities Inc.	527,256	4.3%	570,577
Barclays Capital Inc.	521,437	4.3%	583,016
BNP Paribas Securities Corp.	453,996	3.7%	481,039
Banc of America Securities LLC	395,888	3.2%	429,473
CitiGroup Global Markets Inc.	379,069	3.1%	414,258
Royal Bank of Canada	345,173	2.8%	367,478
UBS Securities Inc.	295,987	2.4%	311,443
Guggenheim Liquidity Services, LLC	240,085	2.0%	252,820
Mizuho Securities USA Inc.	172,289	1.4%	189,794
ING Financial Market LLC	161,437	1.3%	165,683
Jefferies & Company, Inc	129,899	1.1%	138,011
Daiwa Capital Markets America Inc	116,077	1.0%	122,061
Cantor Fitzgerald & Co.	91,076	0.7%	94,932
<b>Total</b>	<b>12,181,845</b>	<b>100.0%</b>	<b>13,218,675</b>
	0,000,000000	0,000,000000	0,000,000000
<b>December 31, 2010</b>			
<b>\$ in thousands</b>			
	<b>Amount</b>	<b>Percent of Total</b>	<b>Company MBS</b>
<b>Repurchase Agreement Counterparties</b>	<b>Outstanding</b>	<b>Amount Outstanding</b>	<b>Held as Collateral</b>
Credit Suisse Securities (USA) LLC	974,369	22.4%	1,072,719
Wells Fargo Securities, LLC	614,365	14.1%	710,529
Morgan Stanley & Co. Incorporated	468,748	10.8%	511,022
Deutsche Bank Securities Inc.	463,087	10.7%	493,533
Barclays Capital Inc.	287,469	6.6%	322,035
Goldman, Sachs & Co.	273,369	6.4%	291,512
Mitsubishi UFJ Securities (USA), Inc.	261,594	6.0%	273,131
BNP Paribas Securities Corp.	228,566	5.3%	239,218
JP Morgan Securities Inc.	227,261	5.2%	255,403
RBS Securities Inc.	210,332	4.8%	241,331
Banc of America Securities LLC	200,081	4.6%	220,018

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Nomura Securities International, Inc.	135,418	3.1%	144,586
<b>Total</b>	<b>4,344,659</b>	<b>100.0%</b>	<b>4,775,037</b>

Company MBS held by counterparties as security for repurchase agreements was \$13.2 billion and \$4.8 billion at September 30, 2011 and December 31, 2010, respectively. This represents a collateral ratio (Company MBS Held as Collateral/Amount Outstanding) of 109% and 110% respectively. The decline in the collateral ratio was due to the change in asset mix as the Company had a higher percentage of credit assets that generally have lower advance rates.

Cash collateral held by the counterparties at September 30, 2011 and December 31, 2010 was \$215.1 million and \$81.3 million, respectively. In addition, cash collateral held by the Company at September 30, 2011 and December 31, 2010 was approximately \$18.4 million and \$11.1 million, respectively.

**Table of Contents****Note 6 Derivatives and Hedging Activities****Risk Management Objective of Using Derivatives**

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of its investments, debt funding, and the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments principally related to the Company's investments and borrowings.

The Company also utilizes credit derivatives such as credit default swaps ( CDS ) to provide credit event protection based on a financial index or specific security in exchange for receiving a fixed-rate fee or premium over the term of the contract. These instruments enable the Company to synthetically assume the credit risk of a reference security, portfolio of securities or index of securities. The counterparty pays a premium to the Company and the Company agrees to make a payment to compensate the counterparty for losses upon the occurrence of a specified credit event.

Although contract-specific, credit events generally include bankruptcy, failure to pay, restructuring, obligation acceleration, obligation default, or repudiation/moratorium. Upon the occurrence of a defined credit event, the difference between the value of the reference obligation and the CDS's notional amount is recorded as a realized loss in the statement of operations.

Our only CDS contract was entered into on December 31, 2010 where the Company sold protection on a specific pool of non-Agency RMBS that exceed a specified loss limit of 25% for a stated fixed rate fee of 3%. The Company's maximum exposure is the unpaid principal balance of the underlying RMBS that exceeds the specified loss limit. The Company is required to post cash collateral to secure potential loss payments.

At September 30, 2011 and December 31, 2010, the open CDS sold by the Company is summarized as follows:

<b>\$ in thousand</b>	<b>September 30, 2011</b>	<b>December 31, 2010</b>
Fair value amount	1,580	
Notional amount	120,647	149,964
Maximum potential amount of future undiscounted payments	90,486	112,500
Recourse provisions with third parties		
Collateral held by counterparty	18,531	

**Cash Flow Hedges of Interest Rate Risk**

The Company finances its activities primarily through repurchase agreements, which are generally settled on a short-term basis, usually from one to three months. At each settlement date, the Company refinances each repurchase agreement at the market interest rate at that time. Since the interest rate on its repurchase agreements change on a one to twelve month basis, the Company is exposed to changing interest rates. The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The effective portion of changes in the fair value of derivatives designated and qualifying as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the

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period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the three months ended September 30, 2011, the Company recorded \$453,000 of unrealized swap losses in earnings as hedge ineffectiveness attributable primarily to differences in the reset dates on the Company's swaps versus the refinancing dates of certain of its repurchase agreements. For the three months ended September 30, 2010, the Company recorded \$9,000 of unrealized swap losses in earnings.

During the nine months ended September 30, 2011, the Company recorded \$655,000 of unrealized swap losses in earnings as hedge ineffectiveness attributable primarily to differences in the reset dates on the Company's swaps versus the refinancing dates of certain of its repurchase agreements. For the nine months ended September 30, 2010, the Company recorded \$44,000 of unrealized swap losses in earnings.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest is accrued and paid on the Company's repurchase agreements. During the next twelve months, the Company estimates that an additional \$128.2 million will be reclassified as an increase to interest expense.

The Company is hedging its exposure to the variability in future cash flows for forecasted transactions over a maximum period of 116 months.

As of September 30, 2011, the Company had the following interest rate derivatives outstanding, that were designated as cash flow hedges of interest rate risk:

Counterparty	Notional	Maturity Date	Fixed Interest Rate in Contract
The Bank of New York Mellon	175,000	8/5/2012	2.07%
The Bank of New York Mellon	100,000	5/24/2013	1.83%
The Bank of New York Mellon	200,000	6/15/2013	1.73%
SunTrust Bank	100,000	7/15/2014	2.79%
Deutsche Bank AG	200,000	1/15/2015	1.08%
Deutsche Bank AG	250,000	2/15/2015	1.14%
Credit Suisse International	100,000	2/24/2015	3.26%
Credit Suisse International	100,000	3/24/2015	2.76%
Wells Fargo Bank, N.A.	100,000	7/15/2015	2.85%
Wells Fargo Bank, N.A.	50,000	7/15/2015	2.44%
Morgan Stanley Capital Services, Inc.	300,000	1/24/2016	2.12%
The Bank of New York Mellon	300,000	1/24/2016	2.13%
Morgan Stanley Capital Services, Inc.	300,000	4/5/2016	2.48%
Citibank, N.A.	300,000	4/15/2016	1.67%
The Bank of New York Mellon	500,000	4/15/2016	2.24%
Credit Suisse International	500,000	4/15/2016	2.27%
JPMorgan Chase Bank, N.A.	500,000	5/16/2016	2.31%
Goldman Sachs Bank USA	500,000	5/24/2016	2.34%
Wells Fargo Bank, N.A.	250,000	6/15/2016	2.67%
Goldman Sachs Bank USA	250,000	6/15/2016	2.67%
JPMorgan Chase Bank, N.A.	500,000	6/24/2016	2.51%
Citibank, N.A.	500,000	10/15/2016	1.93%
Deutsche Bank AG	150,000	2/5/2018	2.90%
Morgan Stanley Capital Services, Inc.	100,000	4/5/2018	3.10%
JPMorgan Chase Bank, N.A.	200,000	5/15/2018	2.93%
Wells Fargo Bank, N.A.	200,000	3/15/2021	3.14%
Citibank, N.A.	200,000	5/25/2021	2.83%
Total	6,925,000		2.29%

At September 30, 2011, the Company's counterparties held approximately \$20.9 million of cash margin deposits and approximately \$446.7 million in Agency RMBS as collateral against its swap contracts. The cash is classified as restricted cash and the Agency RMBS is included in the total mortgage-backed securities on our consolidated balance sheet.



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**Tabular Disclosure of the Effect of Derivative Instruments on the Balance Sheet**

The table below presents the fair value of the Company's derivative financial instruments, as well as their classification on the balance sheet as of September 30, 2011 and December 31, 2010.

\$ in thousands

As of September 30, 2011		As of December 31, 2010		As of September 30, 2011		As of December 31, 2010	
Balance		Balance		Balance		Balance	
Sheet	Fair Value	Sheet	Fair Value	Sheet	Fair Value	Sheet	Fair Value
Interest rate swap asset		Interest rate swap asset	33,255	Interest rate swap liability	388,886	Interest rate swap liability	37,850

**Tabular Disclosure of the Effect of Derivative Instruments on the Income Statement**

The table below presents the effect of the Company's derivative financial instruments on the statement of operations for the three and nine months ended September 30, 2011 and 2010.

Three months ended September 30, 2011

	00,000	00,000	00,000	00,000	00,000
\$ in thousands					
Derivative type for cash flow hedge	Amount of loss recognized in OCI on derivative (effective portion)	Location of loss reclassified from accumulated OCI into income (effective portion)	Amount of loss reclassified from accumulated OCI into income (effective portion)	Location of loss recognized in derivative (ineffective portion)	Amount of loss recognized in income on derivative (ineffective portion)
Interest Rate Swap	301,503	Interest Expense	34,753	Other Expense	453

Nine months ended September 30, 2011

	00,000	00,000	00,000	00,000	00,000
\$ in thousands					
Derivative type for cash flow hedge	Amount of loss recognized in OCI on derivative (effective portion)	Location of loss reclassified from accumulated OCI into income	Amount of loss reclassified from accumulated OCI into income (effective portion)	Location of loss recognized in derivative (ineffective)	Amount of loss recognized in income on derivative (ineffective portion)



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		(effective portion)		(effective portion)	
Interest Rate Swap	450,545	Interest Expense	66,909	Other Expense	655
Three months ended September 30, 2010					

	00,000	00,000	00,000	00,000	00,000
<b>\$ in thousands</b>					
		<b>Location of loss</b>			
		<b>reclassified from</b>		<b>Location of loss</b>	
		<b>accumulated</b>		<b>recognized in</b>	
<b>Derivative</b>		<b>OCI into</b>		<b>income on</b>	
<b>type for</b>	<b>Amount of loss</b>	<b>income</b>	<b>Amount of loss</b>	<b>derivative</b>	<b>Amount of loss</b>
<b>cash flow</b>	<b>recognized in OCI on</b>	<b>(effective</b>	<b>reclassified from</b>	<b>(ineffective</b>	<b>recognized</b>
<b>hedge</b>	<b>derivative (effective portion)</b>	<b>portion)</b>	<b>accumulated OCI into</b>	<b>portion)</b>	<b>in income</b>
Interest Rate Swap	19,663	Interest Expense	4,702	Other Expense	9
Nine months ended September 30, 2010					

	000,000,00000	000,000,00000	000,000,00000	000,000,00000	000,000,00000
<b>\$ in thousands</b>					
		<b>Location of loss</b>			
		<b>reclassified from</b>		<b>Location of loss</b>	
		<b>accumulated</b>		<b>recognized in</b>	
<b>Derivative</b>		<b>OCI into</b>		<b>income on</b>	
<b>type for</b>	<b>Amount of loss</b>	<b>income</b>	<b>Amount of loss</b>	<b>derivative</b>	<b>Amount of loss</b>
<b>cash flow</b>	<b>recognized in OCI on derivative</b>	<b>(effective</b>	<b>reclassified from</b>	<b>(ineffective</b>	<b>recognized</b>
<b>hedge</b>	<b>in OCI on derivative (effective portion)</b>	<b>portion)</b>	<b>accumulated OCI into</b>	<b>portion)</b>	<b>in income</b>
Interest Rate Swap	52,010	Interest Expense	9,572	Other Expense	44

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Derivative	Location of gain	Amount of gain (loss) recognized in income on derivative	
		Three months ended September 30, 2011	Three months ended September 30, 2010
not designated as hedging instrument	recognized in income on derivative		
CDS Contract	Realized and unrealized credit default swap income	(105)	

Derivative	Location of gain	Amount of gain recognized in income on derivative	
		Nine months ended September 30, 2011	Nine months ended September 30, 2010
not designated as hedging instrument	recognized in income on derivative		
CDS Contract	Realized and unrealized credit default swap income	1,580	

**Credit-risk-related Contingent Features**

The Company has agreements with each of its derivative counterparties. Some of those agreements contain a provision where if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations.

The Company has an agreement with one of its derivative counterparties that contains a provision where if the Company's net asset value declines by certain percentages over specified time periods, then the Company could be declared in default on its derivative obligations. The Company also has an agreement with one of its derivative counterparties that contains a provision where if the Company's shareholders' equity declines by certain percentages over specified time periods, then the Company could be declared in default on its derivative obligations.

The Company has an agreement with one of its derivative counterparties that contain a provision where if the Company fails to maintain a minimum shareholders' equity or market value of \$100 million and \$80 million, respectively, then the Company could be declared in default on its derivative obligations.

As of September 30, 2011, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was \$393.9 million. The Company has minimum collateral posting thresholds with certain of its derivative counterparties and has posted collateral of approximately \$20.9 million of cash and \$446.7 million of Agency RMBS. If the Company had breached any of these provisions at September 30, 2011, it could have been required to settle its obligations under the agreements at their termination value. The Company was in compliance with all of the financial provisions of these agreements through September 30, 2011.

**Note 7 Financial Instruments**

U.S. GAAP defines fair value, provides a consistent framework for measuring fair value under U.S. GAAP and Accounting Standards Codification (ASC) Topic 820 expands fair value financial statement disclosure requirements. ASC Topic 820 does not require any new fair value measurements and only applies to accounting pronouncements that already require or permit fair value measures, except for standards that relate to share-based payments.

Valuation techniques are based on observable and unobservable inputs. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect the Company's market assumptions. The three levels are defined as follows:

*Level 1 Inputs* Quoted prices for identical instruments in active markets.

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*Level 2 Inputs* Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

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*Level 3 Inputs* Instruments with primarily unobservable value drivers.

The fair values on a recurring basis of the Company's MBS and interest rate hedges based on the level of inputs at September 30, 2011 and December 31, 2010 are summarized below:

	00,000,000,0	00,000,000,0	00,000,000,0	00,000,000,0
	<b>September 30, 2011</b>			
	<b>Fair Value Measurements Using:</b>			
<b>\$ in thousands</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total at Fair Value</b>
<b>Assets</b>				
Mortgage-backed securities(1)		14,336,951		14,336,951
Investments in unconsolidated ventures			110,907	110,907
Derivatives			1,580	1,580
<b>Total</b>		<b>14,336,951</b>	<b>112,487</b>	<b>14,449,438</b>
<b>Liabilities</b>				
Derivatives		388,886		388,886
<b>Total</b>		<b>388,886</b>		<b>388,886</b>

	00,000,000,0	00,000,000,0	00,000,000,0	00,000,000,0
	<b>December 31, 2010</b>			
	<b>Fair Value Measurements Using:</b>			
<b>\$ in thousands</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total at Fair Value</b>
<b>Assets</b>				
Mortgage-backed securities(1)		5,578,333		5,578,333
Investments in unconsolidated ventures			54,725	54,725
Derivatives		33,255		33,255
<b>Total</b>		<b>5,611,588</b>	<b>54,725</b>	<b>5,666,313</b>
<b>Liabilities</b>				
Derivatives		37,850		37,850
<b>Total</b>		<b>37,850</b>		<b>37,850</b>

(1) For more detail about the fair value of our MBS and type of securities, see Note 3 in the unaudited consolidated financial statements. The following table presents additional information about the Company's investments in unconsolidated ventures which are measured at fair value on a recurring basis for which the Company has utilized Level 3 inputs to determine fair value:

<b>\$ in thousands</b>	<b>September 30, 2011</b>	<b>December 31, 2010</b>
Beginning balance	54,725	4,128

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Purchases	74,366	56,357
Sales and settlements	(20,922)	(14,036)
Total net gains / (losses) included in net income		
Realized gains/(losses), net	6,424	4,780
Unrealized gains/(losses), net	(3,686)	3,496
Unrealized gain/(losses), net included in other comprehensive income		
Ending balance	110,907	54,725

The fair value of the repurchase agreements is based on an expected present value technique. This method discounts future estimated cash flows using rates the Company determined best reflect current market interest rates that would be offered for loans with similar characteristics and credit quality. At September 30, 2011 the repurchase agreements had a fair value of \$12.2 billion and a carrying value of \$12.2 billion. At December 31, 2010 the repurchase agreements had a fair value of \$4.3 billion and a carrying value of \$4.3 billion.

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### **Note 8 Related Party Transactions**

The Company is externally managed and advised by the Manager. Pursuant to the terms of the management agreement, the Manager provides the Company with its management team, including its officers, along with appropriate support personnel. Each of the Company's officers is an employee of Invesco or one of Invesco's affiliates. The Company does not have any employees. With the exception of the Company's Chief Financial Officer, the Manager is not obligated to dedicate any of its employees exclusively to the Company, nor is the Manager or its employees obligated to dedicate any specific portion of its or their time to the Company's business. The Manager is at all times subject to the supervision and oversight of the Company's board of directors and has only such functions and authority as the Company delegates to it.

#### **Management Fee**

The Company pays the Manager a management fee equal to 1.50% of the Company's shareholders' equity per annum, which is calculated and payable quarterly in arrears. For purposes of calculating the management fee, shareholders' equity is equal to the sum of the net proceeds from all issuances of equity securities since inception (allocated on a pro rata daily basis for such issuances during the fiscal quarter of any such issuance), plus retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount paid to repurchase common stock since inception, and excluding any unrealized gains, losses or other items that do not affect realized net income (regardless of whether such items are included in other comprehensive income or loss, or in net income). This amount will be adjusted to exclude one-time events pursuant to changes in U.S. GAAP, and certain non-cash items after discussions between the Manager and the Company's independent directors and approval by a majority of the Company's independent directors.

The Manager has agreed to reduce (but not below zero) the management fee payable by the Company under the management agreement with respect to any equity investment the Company may make in the Invesco PPIP Fund managed by the Manager. The fee reduction occurs at the PPIP level.

For the three months ended September 30, 2011 and 2010, the Company incurred management fees of approximately \$7.9 million and \$2.0 million, respectively of which approximately \$7.9 million and \$2.0 million, respectively, was accrued but had not been paid.

For the nine months ended September 30, 2011 and 2010, the Company incurred management fees of approximately \$17.6 million and \$5.1 million, respectively.

#### **Expense Reimbursement**

Pursuant to the management agreement, the Company is required to reimburse the Manager for operating expenses related to the Company incurred by the Manager, including certain salary expenses and other expenses related to legal, accounting, due diligence and other services. The Company's reimbursement obligation is not subject to any dollar limitation.

The Company incurred costs, originally paid by Invesco, of approximately \$1.6 million and \$4.3 million for the three and nine months ended September 30, 2011, compared to approximately \$629,000 and \$2.7 million for the three and nine months ended September 30, 2010. Approximately \$1.3 million and \$3.5 million was expensed for the three and nine months ended September 30, 2011, compared to \$558,000 and \$1.8 million for the three and nine months ended September 30, 2010. Approximately \$285,000 and \$810,000 was charged against equity as a cost of raising capital for the three and nine months ended September 30, 2011, compared to \$70,000 and \$926,000 for the three and nine months ended September 30, 2010.

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### **Termination Fee**

A termination fee is due to the Manager upon termination of the management agreement by the Company equal to three times the sum of the average annual management fee earned by the Manager during the 24-month period prior to such termination, calculated as of the end of the most recently completed fiscal quarter.

### **Note 9 Shareholders Equity**

#### **Securities Convertible into Shares of Common Stock**

The limited partner who holds units of the Operating Partnership ( OP Units ) has the right to cause the Operating Partnership to redeem their OP Units for cash equal to the market value of an equivalent number of shares of common stock, or at the Company's option, the Company may purchase their OP Units by issuing one share of common stock for each OP Unit redeemed. The Company has also adopted an equity incentive plan which includes the ability of the Company to grant securities convertible into the Company's common stock to the independent directors and the executive officers of the Company and the personnel of the Manager.

#### **Registration Rights**

The Company entered into a registration rights agreement with regard to the common stock and OP Units owned by the Manager and Invesco Investments (Bermuda) Ltd., respectively, upon completion of the Company's IPO and any shares of common stock that the Manager may elect to receive under the management agreement or otherwise. Pursuant to the registration rights agreement, the Company has granted to the Manager and Invesco Investments (Bermuda) Ltd., (i) unlimited demand registration rights to have the shares purchased by the Manager or granted to it in the future and the shares that the Company may issue upon redemption of the OP Units purchased by Invesco Investments (Bermuda) Ltd. registered for resale, and (ii) in certain circumstances, the right to piggy-back these shares in registration statements the Company might file in connection with any future public offering so long as the Company retains the Manager under the management agreement.

#### **Public Offerings**

During the quarter ended September 30, 2011, the Company issued 1,389,200 shares of common stock at an average price of \$18.90 under the Company's Direct Stock Purchase Plan ( DSPP ) with total proceeds to the Company of approximately \$26.1 million, net of issuance costs.

On August 23, 2011, the Company completed a follow-on public offering of 20,000,000 shares of common stock at \$18.37 per share. Net proceeds to the Company were \$362.2 million, net of issuance costs of approximately \$5.2 million.

#### **Share-Based Compensation**

The Company established the 2009 Equity Incentive Plan for grants of restricted common stock and other equity based awards to the independent directors and the executive officers of the Company and personnel of the Manager (the Incentive Plan ). Under the Incentive Plan, a total of 1,000,000 shares of common stock are currently reserved for issuance. Unless terminated earlier, the Incentive Plan will terminate in 2019, but will continue to govern the unexpired awards. The Company recognized compensation expense of approximately \$38,000 and approximately \$19,000 for the three months ended September 30, 2011 and 2010, respectively. The Company recognized compensation expense of approximately \$105,000 and approximately \$71,000 for the nine months ended September 30, 2011 and 2010, respectively. During the three months ended September 30, 2011 and 2010, the Company issued 1,722 and 915 shares, respectively, of restricted stock pursuant to the Incentive Plan to the Company's non-executive directors. During the nine months ended September 30, 2011 and 2010, the Company issued 4,617 and 2,670 shares, respectively, of restricted stock pursuant to the Incentive Plan to the Company's non-executive directors. The fair market value of the shares granted was determined by the closing stock market price on the date of the grant.

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Compensation related to stock awards to officers and employees of the Manager are recorded at the estimated fair value of the award during the vesting period. The Company makes an upward or downward adjustment to compensation expense for the difference in the fair value at the date of grant and the date the award was earned. The Company recognized compensation expense of approximately \$8,000 for the three months ended September 30, 2011 related to awards to officers and employees of the Manager. The Company recognized compensation expense of approximately \$44,000 for the nine months ended September 30, 2011 related to awards to officers and employees of the Manager.

**Dividends**

On September 8, 2011, the Company declared a dividend of \$0.80 per share of common stock. The dividend was paid on October 27, 2011 to shareholders of record as of the close of business on September 19, 2011.

**Note 10 Earnings per Share**

Earnings per share for the three and nine months ended September 30, 2011 and 2010 is computed as follows:

\$ in thousands	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>Numerator (Income)</b>				
Basic Earnings				
Net income available to common shareholders	81,084	26,186	206,330	58,985
Effect of dilutive securities:				
Income allocated to non-controlling interest	1,091	1,433	3,948	3,860
Dilutive net income available to shareholders	82,175	27,619	210,278	62,845
<b>Denominator (Weighted Average Shares)</b>				
Basic Earnings:				
Shares available to common shareholders	103,028	26,047	76,311	21,552
Effect of dilutive securities:				
Restricted Stock Awards	19	6	14	4
OP Units	1,425	1,425	1,425	1,425
Dilutive Shares	104,472	27,478	77,750	22,981

**Note 11 Non-controlling Interest - Operating Partnership**

Non-controlling interest represents the aggregate OP Units in the Operating Partnership held by limited partners (the Unit Holders). Income allocated to the non-controlling interest is based on the Unit Holders' ownership percentage of the Operating Partnership. The ownership percentage is determined by dividing the number of OP Units held by the Unit Holders by the total number of dilutive shares of common stock. The issuance of common stock (Share or Shares) or OP Units changes the percentage ownership of both the Unit Holders and the holders of common stock. Since an OP unit is generally redeemable for cash or Shares at the option of the Company, it is deemed to be equivalent to a Share. Therefore, such transactions are treated as capital transactions and result in an allocation between shareholders' equity and non-controlling interest in the accompanying consolidated balance sheet to account for the change in the ownership of the underlying equity in the Operating Partnership. As of September 30, 2011 and 2010, non-controlling interest related to the outstanding 1,425,000 OP units represented a 1.2% and 5.2% interest in the Operating Partnership, respectively. Income allocated to the Operating Partnership non-controlling interest for the three months ended September 30, 2011 and 2010 was approximately \$1.1 million and \$1.4 million, respectively. Income allocated to the Operating Partnership non-controlling interest for the nine months ended September 30, 2011 and 2010 was approximately \$3.9 million and \$3.9 million, respectively. For the three months ended September 30, 2011 and 2010, distributions paid to the non-controlling interest were \$1.4 million and \$1.1 million, respectively. For the nine months ended September 30, 2011 and 2010, distributions paid to the non-controlling interest were \$4.2 million and \$3.7 million, respectively. As of September 30, 2011 and 2010, distributions payable to the non-controlling interest were approximately \$1.1 million and \$1.4 million, respectively.





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**Note 12 Subsequent Events**

The Company has reviewed subsequent events occurring through the date that these consolidation financial statements were issued, and determined that no subsequent events occurred that would require accrual or additional disclosure.

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

*In this quarterly report on Form 10-Q, or this Report, we refer to Invesco Mortgage Capital Inc. and its consolidated subsidiaries as we, us, our Company, or our, unless we specifically state otherwise or the context indicates otherwise. We refer to our external manager, Invesco Advisers, Inc., as our Manager, and we refer to the indirect parent company of our Manager, Invesco Ltd. (NYSE:IVZ,) together with its consolidated subsidiaries (other than us), as Invesco.*

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 Item 1 of this report, as well as the information contained in our most recent Form 10-K filed with the Securities and Exchange Commission (the SEC).

#### **Forward-Looking Statements**

We make forward-looking statements in this Report and other filings we make with the 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, 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, financial condition, liquidity, results of operations, plans and objectives. When we use the words believe, expect, anticipate, estimate, plan, continue, intend, should, may or similar expressions and future or conditional verbs such as will, may, 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 the Company's forward-looking statements include, but are not limited to:

the impact of any deficiencies in foreclosure practices of third parties and related delays in the foreclosure process;

our business and investment strategy;

our investment portfolio;

our projected operating results;

actions and initiatives of the U.S. government, including the impact of the final agreement on the U.S. debt ceiling and budget deficit; and changes to U.S. government policies, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) and our ability to respond to and comply with such actions, initiatives and changes;

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;

general volatility of the securities markets in which we invest;

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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;

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our ability to maintain sufficient liquidity to meet any margin calls;

changes in interest rates and the market value of our target assets;

changes in prepayment rates on our target assets;

effects of hedging instruments on our target assets;

rates of default or decreased recovery rates on our target assets;

modifications to whole loans or loans underlying securities;

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

changes in governmental regulations, tax law and rates, and similar matters and our ability to respond to such changes;

our ability to maintain our qualification as a REIT for U.S. federal income tax purposes;

our ability to maintain our exemption from registration 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;

estimates relating to our ability to continue to make distributions to our shareholders;

availability of qualified personnel;

our understanding of our competition;

changes to accounting principles generally accepted in the United States of America ( US GAAP ); and

market trends in our industry, interest rates, real estate values, the debt securities markets or the general economy.

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These forward-looking statements are based upon information presently available to our management and are inherently subjective, uncertain and subject to change. There can be no assurance that actual results will not differ materially from our expectations. We caution investors not to rely unduly on any forward-looking statements and urge you to carefully consider the risks identified under the captions "Risk Factors,"

Forward-Looking Statements" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Report and our most recent Form 10-K and subsequent Forms 10-Q, which are available on the SEC's website at [www.sec.gov](http://www.sec.gov).

All written or oral forward-looking statements that we make, or that are attributable to us, are expressly qualified by this cautionary notice. We expressly disclaim any obligation to update the information in any public disclosure if any forward-looking statement later turns out to be inaccurate, except as may otherwise be required by law.

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### **Overview**

We are a Maryland corporation primarily focused on investing in, financing and managing residential and commercial mortgage-backed securities and mortgage loans. Our common stock is listed on the New York Stock Exchange under the symbol **IVR**. We are externally managed and advised by Invesco Advisers, Inc., our Manager, which is an indirect, wholly-owned subsidiary of Invesco Ltd. We elected to qualify to be taxed as a REIT commencing with our taxable year ended December 31, 2009. Accordingly, we generally will not be subject to U.S. federal income taxes on our taxable income that we distribute currently to our shareholders as long as we maintain our qualification as a REIT. We operate our business in a manner that will permit us to maintain our exemption from registration under the 1940 Act.

Our objective is to provide attractive risk-adjusted returns to our shareholders, primarily through dividends and secondarily through capital appreciation. To achieve this objective, we primarily invest in the following:

Agency RMBS, which are residential mortgage-backed securities, for which 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** ) guarantees payments of principal and interest on the securities;

Non-Agency RMBS, which are RMBS that are not issued or guaranteed by a U.S. government agency or a federally chartered corporation;

CMBS, which are commercial mortgage-backed securities; and

Residential and commercial mortgage loans.

We finance our investments in Agency RMBS, non-Agency RMBS and CMBS through short-term borrowings structured as repurchase agreements. We have also financed our investments in certain non-Agency RMBS, CMBS and residential and commercial mortgage loans by contributing capital to one or more of the legacy securities public-private investment funds ( **PPIFs** ) that receive financing under the U.S. government's Public-Private Investment Program ( **PPIP** ), established and managed by our Manager (the **Invesco PPIP Fund** ), which, in turn, invests in our target assets.

### **Recent Developments**

During the quarter ended September 30, 2011, we issued 1,389,200 shares of common stock at an average price of \$18.90 under the Company's Direct Stock Purchase Plan with total proceeds to us of approximately \$26.1 million, net of issuance costs.

On September 8, 2011, we declared a dividend of \$0.80 per share of common stock. The dividend was paid on October 27, 2011 to shareholders of record as of the close of business on September 19, 2011.

On August 23, 2011, we completed a follow-on public offering of 20,000,000 shares of common stock at \$18.37 per share. Net proceeds to us were approximately \$362.2 million, net of issuance costs of approximately \$5.2 million.

### **Factors Impacting Our Operating Results**

Our operating results can be affected by a number of factors, many of which are beyond our control, and primarily depend on, among other things, the level of our net interest income, the market value of our assets and the supply of, and demand for, the target assets in which we invest. 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.





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### **Market Conditions**

Beginning in the summer of 2007, significant adverse changes in financial market conditions resulted in a deleveraging of the entire global financial system. As part of this process, residential and commercial mortgage markets in the United States experienced a variety of difficulties, including loan defaults, credit losses and reduced liquidity. As a result, many lenders tightened their lending standards, reduced lending capacity, liquidated significant portfolios or exited the market altogether, and therefore, financing with attractive terms was generally unavailable. It remains unclear when the economy will fully recover. Further volatility and deterioration in the residential and commercial mortgage markets could adversely impact the performance and market value of our target assets and interest rate swaps.

The Dodd-Frank Act enacted on July 21, 2010, contains numerous provisions affecting the financial and mortgage industries, many of which may have an impact on our operating environment and the target assets in which we invest. Consequently, the Dodd-Frank Act may affect our cost of doing business, may limit our investment opportunities and may affect the competitive balance within our industry and market areas.

The Federal Housing Finance Agency ( FHFA ) and the Department of the Treasury introduced the Home Affordable Refinance Program ( HARP ) in early 2009. HARP provides borrowers, who may not otherwise qualify for refinancing because of declining home values or reduced access to mortgage insurance, the ability to refinance their mortgages into a lower interest rate and/or more stable mortgage product. On October 24, 2011, the FHFA announced a series of changes to the rules regarding the HARP with intent of increasing the number of borrowers eligible to refinance their mortgage under this program. While final guidance is not due until November 15, 2011, the FHFA announced the changes to the guidelines, related to loan-to-value, appraisals, and certain fees, among other things, subject to a variety of qualifications and the extension of the end date for the HARP until December 31, 2013. It does not change the time period which these loans were originated, maintaining the requirement that the loans must have been guaranteed by Fannie Mae or Freddie Mac on or before May 31, 2009. We do not expect the current HARP or future modifications to have a material impact on our results of operations in future periods.

### **Investment Activities**

As of September 30, 2011, 50.8% of our equity was invested in Agency RMBS, 29.9% in non-Agency RMBS, 13.6% in CMBS, and 5.7% in the Invesco PPIP Fund and other investments in unconsolidated ventures. We use leverage on our target assets to achieve our return objectives. For our total investment portfolio, we focus on securities we believe provide attractive returns when levered approximately 3 to 7 times. The leverage on classes of assets may periodically exceed the stated ranges as we adjust our borrowings to obtain the best available source and minimize total interest expense, while maintaining our overall portfolio leverage guidelines.

As of September 30, 2011, we had approximately \$6.2 billion in 30-year fixed rate securities that offered higher coupons and call protection based on the collateral attributes. We balanced this with approximately \$2.5 billion in 15-year fixed rate securities, approximately \$1.3 billion in hybrid adjustable-rate mortgages ( ARMs ) and approximately \$96.7 million in ARMs we believe to have similar durations based on prepayment speeds. As of September 30, 2011, we had purchased approximately \$2.2 billion non-Agency RMBS fixed rate mortgages and \$418.3 million non-Agency RMBS ARMs.

Initially, we focused on CMBS that could be financed under the TALF. In November 2010, the Company exercised its right to prepay the TALF loans secured by CMBS. The purpose for the prepayment was to obtain lower borrowing costs. The Company obtained additional advances under existing repurchase agreement financing arrangements. As of September 30, 2011, we owned approximately \$1.4 billion in CMBS and financed \$1.0 billion in repurchase agreements. In addition, as of September 30, 2011, we had purchased approximately \$143.4 million in CMOs.

During the three months ended September 30, 2011, we purchased approximately \$3.5 billion of mortgage-backed securities. The average yield on these purchases as of September 30, 2011 is 4.40%.

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*Investment Portfolio*

The following table summarizes certain characteristics of our investment portfolio as of September 30, 2011:

<b>\$ in thousands</b>	<b>Principal Balance</b>	<b>Unamortized Premium (Discount)</b>	<b>Amortized Cost</b>	<b>Unrealized Gain/ (Loss)</b>	<b>Fair Value</b>	<b>Net Weighted Average Coupon <sup>(1)</sup></b>	<b>Average Yield <sup>(2)</sup></b>
<b>Agency RMBS:</b>							
15 year fixed-rate	2,360,188	128,782	2,488,970	43,399	2,532,369	4.33 %	3.13 %
30 year fixed-rate	5,701,102	400,866	6,101,968	110,900	6,212,868	5.17 %	3.94 %
ARM	92,785	1,850	94,635	2,087	96,722	3.53 %	3.14 %
Hybrid ARM	1,267,544	28,045	1,295,589	23,359	1,318,948	3.31 %	2.81 %
<b>Total Agency</b>	<b>9,421,619</b>	<b>559,543</b>	<b>9,981,162</b>	<b>179,745</b>	<b>10,160,907</b>	<b>4.69 %</b>	<b>3.59 %</b>
<b>MBS-CMO</b>	<b>629,502</b>	<b>(487,871)</b>	<b>141,631</b>	<b>1,769</b>	<b>143,400</b>	<b>3.30 %</b>	<b>6.24 %</b>
Non-Agency RMBS <sup>(3)</sup>	3,061,712	(316,705)	2,745,007	(79,399)	2,665,608	5.84 %	6.39 %
CMBS	1,492,384	(21,422)	1,470,962	(103,926)	1,367,036	5.48 %	5.66 %
<b>Total</b>	<b>14,605,217</b>	<b>(266,455)</b>	<b>14,338,762</b>	<b>(1,811)</b>	<b>14,336,951</b>	<b>4.70 %</b>	<b>4.11 %</b>

(1) Net weighted average coupon ( WAC ) is presented net of servicing and other fees.

(2) Average yield incorporates future prepayment and loss assumptions.

(3) The non-Agency RMBS held by the Company is 84.3% fixed rate and 15.7% floating rate, based on fair value.

The following table summarizes certain characteristics of our investment portfolio, at fair value, according to their estimated weighted average life classifications as of September 30, 2011:

<b>\$ in thousands</b>	<b>September 30, 2011</b>
Less than one year	82,942
Greater than one year and less than five years	12,098,705
Greater than or equal to five years	2,155,304
<b>Total</b>	<b>14,336,951</b>

The following table presents certain information about the carrying value of our available for sale MBS at September 30, 2011:

<b>\$ in thousands</b>	<b>September 30, 2011</b>
Principal balance	14,605,217
Unamortized premium	589,517
Unamortized discount	(855,972)
Gross unrealized gains	221,213
Gross unrealized losses	(223,024)
<b>Fair value</b>	<b>14,336,951</b>

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The following table summarizes our non-Agency RMBS portfolio by asset type as of September 30, 2011 and June 30, 2011, respectively:

\$ in thousands	September 30, 2011	% of Non-Agency	June 30, 2011	% of Non-Agency
Re-REMIC Senior	1,640,916	61.6%	1,074,303	46.3%
Prime	708,575	26.6%	820,792	35.4%
Alt-A	304,551	11.4%	412,640	17.8%
Subprime	11,566	0.4%	12,686	0.5%
<b>Total Non-Agency</b>	<b>2,665,608</b>	<b>100.0%</b>	<b>2,320,421</b>	<b>100.0%</b>

A re-securitization of a real estate mortgage investment conduit ( re-REMIC ) is a re-securitization of an existing bond or bonds in which the bonds are transferred to a securitization trust. These transactions will create a subordinated interest in the underlying bond which will absorb any losses prior to the senior tranche.

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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 U.S. government agency underwriting guidelines, though in certain cases they may not meet the same income documentation or other requirements.

Alt-A mortgage loans are mortgage loans made to borrowers whose qualifying mortgage characteristics do not conform to U.S. government agency underwriting guidelines, but whose borrower characteristics may conform. 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 are loans that do not conform to U.S. government agency underwriting guidelines. Subprime borrowers generally have imperfect or impaired credit histories and/or low credit scores.

During the third quarter of 2011, the Company increased the portfolio of non-Agency RMBS by \$345.2 million and adjusted its non-Agency RMBS asset allocation. With the completion of the August follow-on offering, the Company increased the percentage of its non-Agency RMBS portfolio allocated to re-REMIC Senior RMBS to 61.6% from 46.3% for the three months ended September 30, 2011 and June 30, 2011, respectively.

*Financing and Other Liabilities.* We enter into repurchase agreements to finance the majority of our Agency RMBS, non-Agency RMBS and CMBS. These agreements are secured by our Agency RMBS, non-Agency RMBS and CMBS and bear interest at rates that have historically moved in close relationship to the London Interbank Offer Rate ( LIBOR ). As of September 30, 2011, we had entered into repurchase agreements totalling \$12.2 billion. We also committed to invest up to \$100.0 million in the Invesco PPIP Fund, which, in turn, invests in our target assets. As of September 30, 2011, approximately \$95.3 million of our commitment to the Invesco PPIP Fund has been called. In addition, we committed to invest up to \$40.0 million in IMRF Loan Portfolio Member LLC. As of September 30, 2011, our commitment was fully funded.

The Company records the liability for mortgage-backed securities purchased for which settlement has not taken place as an investment related payable. As of September 30, 2011 and December 31, 2010, the Company had investment related payables of \$640.8 million and \$372.3 million, respectively, of which no items were outstanding greater than thirty days. The change in balance was primarily due to an increase in mortgage-backed security purchases and unsettled repurchase agreements at quarter end related to our follow-on common stock issuance on August 23, 2011.

*Hedging Instruments.* We generally hedge as much of our interest rate 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 interest rate risk that we are required to hedge.

Interest rate 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 hedge may not match the duration of the related liability;

the party owing money in the hedging transaction may default on its obligation to pay;

the credit quality of the party 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 value of derivatives used for hedging may be adjusted from time to time in accordance with accounting rules to reflect changes in fair value. Downward adjustments or mark-to-market losses would reduce our shareholders' equity.



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As of September 30, 2011, we have entered into interest rate swap agreements designed to mitigate the effects of increases in interest rates under a portion of our repurchase agreements. These swap agreements provide for fixed interest rates indexed off of one-month LIBOR and effectively fix the floating interest rates on \$6.9 billion of borrowings under our repurchase agreements as of September 30, 2011. We intend to continue to add interest rate hedge positions according to our hedging strategy.

The following table summarizes our hedging activity as of September 30, 2011:

Counterparty	Notional	Maturity Date	Fixed Interest Rate in Contract
The Bank of New York Mellon	175,000	8/5/2012	2.07%
The Bank of New York Mellon	100,000	5/24/2013	1.83%
The Bank of New York Mellon	200,000	6/15/2013	1.73%
SunTrust Bank	100,000	7/15/2014	2.79%
Deutsche Bank AG	200,000	1/15/2015	1.08%
Deutsche Bank AG	250,000	2/15/2015	1.14%
Credit Suisse International	100,000	2/24/2015	3.26%
Credit Suisse International	100,000	3/24/2015	2.76%
Wells Fargo Bank, N.A.	100,000	7/15/2015	2.85%
Wells Fargo Bank, N.A.	50,000	7/15/2015	2.44%
Morgan Stanley Capital Services, Inc.	300,000	1/24/2016	2.12%
The Bank of New York Mellon	300,000	1/24/2016	2.13%
Morgan Stanley Capital Services, Inc.	300,000	4/5/2016	2.48%
Citibank, N.A.	300,000	4/15/2016	1.67%
The Bank of New York Mellon	500,000	4/15/2016	2.24%
Credit Suisse International	500,000	4/15/2016	2.27%
JPMorgan Chase Bank, N.A.	500,000	5/16/2016	2.31%
Goldman Sachs Bank USA	500,000	5/24/2016	2.34%
Wells Fargo Bank, N.A.	250,000	6/15/2016	2.67%
Goldman Sachs Bank USA	250,000	6/15/2016	2.67%
JPMorgan Chase Bank, N.A.	500,000	6/24/2016	2.51%
Citibank, N.A.	500,000	10/15/2016	1.93%
Deutsche Bank AG	150,000	2/5/2018	2.90%
Morgan Stanley Capital Services, Inc.	100,000	4/5/2018	3.10%
JPMorgan Chase Bank, N.A.	200,000	5/15/2018	2.93%
Wells Fargo Bank, N.A.	200,000	3/15/2021	3.14%
Citibank, N.A.	200,000	5/25/2021	2.83%
Total	6,925,000		2.29%

Approximately \$500.0 million of the total \$6.9 billion of the swap notional amount on September 30, 2011 were forward-starting interest rate swaps with effective dates beyond September 30, 2011.

With the recent Federal Reserve action to contain short-term rates low through 2013, we have added duration assets from the August 2011 follow-on public offering and have not added any additional interest rate swaps. At September 30, 2011, the average maturity of our interest rate swaps is 4.7 years compared to 4.9 years at June 30, 2011.

**Credit Default Swap Agreement**

We entered into a credit default swap ( CDS ) on December 31, 2010 with a \$150.0 million notional balance and a fair value of \$0. Under this CDS, we sold protection (and receive premium payments of 3% on the outstanding notional amount) on a specific pool of non-Agency RMBS that exceed a specified loss limit of 25%. Our maximum exposure is the unpaid principal balance of the underlying RMBS that exceeds the specified loss limit. The CDS is not designated as a hedging instrument therefore the unrealized loss of \$105,000 and an unrealized gain of \$1.6 million is included in the gain on credit default swap in the statement of operations for the three and nine months ended September 30, 2011, respectively.



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At September 30, 2011, the open CDS sold by us is summarized as follows:

\$ in thousand	September 30, 2011	December 31, 2010
Fair value amount	1,580	
Notional amount	120,647	149,964
Maximum potential amount of future undiscounted payments	90,486	112,500
Recourse provisions with third parties		
Collateral held by counterparty	18,531	

**Book Value per Share**

Our book value per share was \$16.47 and \$20.49 as of September 30, 2011 and December 31, 2010, respectively, on a fully diluted basis, after giving effect to our units of limited partnership interest in our operating partnership, which may be converted to common shares at the sole election of the Company. The decline in our book value was primarily due to the change in valuation of our investment portfolio and our interest rate hedges that is recorded in Other Comprehensive Income (Loss) on our balance sheet. The value of our assets and liabilities change daily based on market conditions. Refer to Item 3. Quantitative and Qualitative Disclosures About Market Risks for interest rate risk and its impact on fair value.

**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. Our most critical accounting policies involve decisions and assessments that could affect our reported assets and liabilities, as well as our reported revenues and expenses. We believe that all of the decisions and assessments upon which our consolidated financial statements are based are reasonable at the time made and based upon information available to us at that time. We rely upon independent pricing of our assets at each quarter's end to arrive at what we believe to be reasonable estimates of fair market value. The complete listing of our Critical Accounting Policies was disclosed in our 2010 annual report on Form 10-K as filed with the SEC on March 14, 2011, and there have been no material changes to our Critical Accounting Policies as disclosed therein.

**Results of Operations**

The table below presents certain information from our Consolidated Statement of Operations for the three and nine month periods ending September 30, 2011 and 2010.

\$ in thousands, except per share data	Three Months ended September 30,		Nine Months ended September 30,	
	2011	2010	2011	2010
<b>Revenues</b>				
Interest income	138,291	36,067	315,808	83,284
Interest expense	50,452	8,873	100,237	18,904
<b>Net interest income</b>	87,839	27,194	215,571	64,380
<b>Other income</b>	3,049	3,349	15,174	6,398
<b>Expenses</b>				
Management fee related party	7,884	2,039	17,612	5,094
General and administrative	829	885	2,855	2,839
<b>Total expenses</b>	8,713	2,924	20,467	7,933



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Net income	82,175	27,619	210,278	62,845
Net income attributable to non-controlling interest	1,091	1,433	3,948	3,860
Net income attributable to common shareholders	81,084	26,186	206,330	58,985

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<b>Earnings per share:</b>				
Net income attributable to common shareholders (basic/diluted)	0.79	1.01	2.70	2.74
Dividends declared per common share	0.80	1.00	2.77	2.52
<b>Weighted average number of shares of common stock:</b>				
Basic	103,028	26,047	76,311	21,552
Diluted	104,472	27,478	77,750	22,981

The table below presents certain information for our portfolio for the three and nine month periods ending September 30, 2011 and 2010.

\$ in thousands	Three Months ended September 30,		Nine Months ended September 30,	
	2011	2010	2011	2010
<b>Average Balances*:</b>				
Agency RMBS:				
15 year fixed-rate, at fair value (Including CMOs)	2,483,276	683,692	2,185,511	522,204
30 year fixed-rate, at fair value	5,594,412	701,684	4,025,616	544,444
ARM, at fair value	111,690	8,280	81,816	8,911
Hybrid ARM, at fair value	1,315,546	42,644	901,972	96,340
Non-Agency RMBS, at fair value	2,505,260	732,920	1,893,772	557,729
CMBS, at fair value	1,314,045	211,815	904,505	200,931
Average MBS portfolio	13,324,229	2,381,035	9,993,192	1,930,559
<b>Average Portfolio Yields (1):</b>				
Agency RMBS:				
15 year fixed-rate, (Including CMOs)	2.86%	3.18%	3.08%	3.18%
30 year fixed-rate	3.66%	4.17%	3.59%	3.82%
ARM	3.11%	2.56%	3.01%	2.45%
Hybrid ARM	2.57%	2.04%	2.60%	0.84%
Non-Agency RMBS	6.63%	11.19%	7.14%	11.27%
CMBS	5.67%	4.77%	5.31%	4.84%
Average MBS portfolio	4.15%	6.06%	4.21%	5.75%
<b>Average Borrowings*:</b>				
Agency RMBS	8,399,111	1,295,270	6,468,159	1,067,201
Non-Agency RMBS	1,998,255	409,786	1,383,534	276,797
CMBS	1,069,243	157,870	737,356	154,112
Total borrowed funds	11,466,609	1,862,926	8,589,049	1,498,110
<b>Average Cost of Funds (2):</b>				
Agency RMBS	0.25%	0.30%	0.25%	0.26%
Non-Agency RMBS	1.39%	1.76%	1.37%	1.60%
CMBS	1.35%	3.52%	1.28%	3.38%
Unhedged cost of funds	0.55%	0.90%	0.52%	0.83%
Hedged cost of funds	1.76%	1.91%	1.56%	1.68%
<b>Average Equity (3):</b>				
Average debt/equity ratio (average during period)	6.21x	3.32x	5.63x	3.13x
Debt/equity ratio (as of period end)	6.33x	3.41x	6.33x	3.41x

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- \* Average amounts for each period are based on weighted month end balances, all percentages are annualized.
- (1) Average portfolio yield for the period was calculated by dividing interest income, including amortization of premiums and discounts, by our average of the investment balance at fair value.
  - (2) Average cost of funds is calculated by dividing interest expense, by our average borrowings.
  - (3) Average equity is calculated based on a weighted balance basis.

**Table of Contents****Net Income Summary**

For the three months ended September 30, 2011, our net income was \$82.2 million or \$0.79 basic and diluted income per weighted average share available to common shareholders compared to \$27.6 million or \$1.01 basic and diluted income per weighted average share available to common shareholders for the three months ended September 30, 2010.

For the nine months ended September 30, 2011, our net income was \$210.3 million or \$2.70 basic and diluted income per weighted average share available to common shareholders compared to \$62.8 million or \$2.74 basic and diluted income per weighted average share available to common shareholders for the nine months ended September 30, 2010.

The increase to net income for the three and nine month periods is primarily attributable to the growth in our investment portfolio resulting from our follow-on common stock offerings. The average MBS portfolio increased approximately \$10.9 million and \$8.1 million for the three and nine months ended September 30, 2011 compared to the three and nine months ended September 30, 2010. Since September 30, 2010, we completed five follow-on common stock offerings raising approximately \$1.8 billion in equity.

**Interest Income and Average Earning Asset Yield**

Our primary source of income is interest earned on our investment portfolio. We had average earning assets of \$13.3 billion and \$2.4 billion and earned interest income of \$138.3 million and \$36.1 million for the three months ended September 30, 2011 and 2010, respectively. The yield on our average investment portfolio was 4.15% and 6.06% for the respective periods. The change in our average assets and the portfolio yield was primarily the result of the change in our portfolio composition as we have allocated a higher amount of equity to Agency RMBS at lower yields and higher leverage.

We had average earning assets of \$10.0 billion and \$1.9 billion and earned interest income of \$315.8 million and \$83.3 million for the nine months ended September 30, 2011 and 2010, respectively. The yield on our average investment portfolio was 4.21% and 5.75% for the respective periods. The change in our average assets and the portfolio yield was primarily the result of the change in our portfolio composition as we have allocated a higher amount of equity to Agency RMBS at lower yields and higher leverage.

Our interest income is subject to interest rate risk. Refer to Item 3. Quantitative and Qualitative Disclosures about Market Risk for more information relating to interest rate risk and its impact on our operating results.

The CPR of our portfolio impacts the amount of premium and discount on the purchase of securities that is recognized into income. Our Agency and non-Agency RMBS had a weighted average CPR of 8.7 and 8.1 for the three months ended September 30, 2011 and June 30, 2011, respectively. The table below shows the three month CPR for our RMBS compared to bonds with similar characteristics ( Cohorts ):

	September 30, 2011		June 30, 2011	
	Company	Cohort	Company	Cohort
15 year Agency RMBS	9.1	20.5	7.7	12.8
30 year Agency RMBS	9.8	16.2	9.2	13.0
Agency Hybrid ARM RMBS	14.9	NA	5.6	N/A
Non-Agency RMBS	8.1	NA	11.5	N/A
Overall	8.7	NA	8.1	N/A

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

Our largest expense is the interest expense on borrowed funds. We had average borrowed funds of \$11.5 billion and \$1.9 billion and total interest expense of \$50.5 million and \$8.9 million for the three months ended September 30, 2011 and 2010, respectively. The increase in average borrowed funds and interest expense was primarily the result of increasing the size of our investment portfolio.

We had average borrowed funds of \$8.6 billion and \$1.5 billion and total interest expense of \$100.2 million and \$18.9 million for the nine months ended September 30, 2011 and 2010, respectively. The increase in average borrowed funds and interest expense was primarily the result of increasing the size of our investment portfolio and hedging costs from additional interest rate swaps.

Our average cost of funds was 1.76% and 1.91% for the three months ended September 30, 2011 and 2010, respectively. Since a substantial portion of our repurchase agreements are short term, changes in market rates are directly reflected in our interest expense. Interest expense includes borrowing costs, as well as any hedging costs.

Our average cost of funds was 1.56% and 1.68% for the nine months ended September 30, 2011 and 2010, respectively. Since a substantial portion of our repurchase agreements are short term, changes in market rates are directly reflected in our interest expense. Interest expense includes borrowing costs, as well as any hedging costs.

### **Net Interest Income**

Our net interest income, which equals interest income less interest expense, totaled \$87.8 million and \$27.2 million for the three months ended September 30, 2011 and 2010, respectively. 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 2.39% and 4.15% for the three months ended September 30, 2011 and 2010, respectively. The increase in net interest income was primarily the result of increasing our investment portfolio while the decrease in our net interest margin was a direct result of our change in asset mix and the impact of additional cost of funds related to our interest rate hedges.

Our net interest income totaled \$215.6 million and \$64.4 million for the nine months ended September 30, 2011 and 2010, respectively. Our net interest rate margin was 2.65% and 4.07% for the nine months ended September 30, 2011 and 2010, respectively. The increase in net interest income was primarily the result of increasing our investment portfolio while the decrease in our net interest margin was a direct result of our change in asset mix between Agency RMBS, non-Agency RMBS and CMBS. Refer to the average balance table in the Results of Operations section above for changes in average portfolio balance and asset mix.

### **Other Income**

As part of our credit process, all of our MBS are reviewed on a monthly basis 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 a result of our change in market assumptions, we sold securities and recognized net gain of approximately \$3.6 million and a net loss of \$311,000 for the three month periods ended September 30, 2011 and 2010, respectively.

As a result of our change in market assumptions, we sold securities and recognized net gain of approximately \$8.4 million and \$1.1 million for the nine month periods ended September 30, 2011 and 2010, respectively.

For the three months ended September 30, 2011 and 2010, we recognized equity in earnings of approximately \$823,000 and \$2.0 million, respectively, and unrealized loss on the change in fair value of our investment in the Invesco PPIP Fund of approximately \$1.8 million and unrealized income on the change in fair value of our investment in the Invesco PPIP Fund of approximately \$1.8 million, respectively. The net decrease in equity in earnings is attributed to a reduction to the underlying investments through dispositions by the PPIP Fund, and the net unrealized loss on the change in fair value was primarily the result of a decrease in the fair value of the remaining underlying investments held by the PPIP Fund.

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For the nine months ended September 30, 2011 and 2010, we recognized equity in earnings of approximately \$6.4 million and \$3.8 million, respectively, and unrealized loss on the change in fair value of our investment in the Invesco PPIP Fund of approximately \$3.7 million and unrealized income on the change in fair value of our investment in the Invesco PPIP Fund of approximately \$2.1 million, respectively. The net earnings from the unconsolidated limited partnership were primarily the result of a gain realized offset by a decrease in the fair value of the PPIP Fund.

For the three months ended September 30, 2011 we recognized income of \$858,000 on our investment in a CDS of which \$105,000 is an unrealized loss based on change in the fair market value of the CDS and \$1.0 million represents premium payments we receive for providing protection.

For the nine months ended September 30, 2011 we recognized income of \$4.6 million on our investment in a CDS of which \$1.6 million is an unrealized gain based on change in the fair market value of the CDS and \$3.0 million represents premium payments we receive for providing protection.

## **Expenses**

We incurred management fees of \$7.9 million and \$2.0 million for the three months ended September 30, 2011, and 2010, respectively, which are payable to our Manager under our management agreement. The increase in management fees is attributable to an increase in shareholders equity resulting from our follow-on common stock offerings in 2010 and 2011. This management fee and the relationship between the Company and the Manager are discussed further in our discussion of related party relationships.

We incurred management fees of \$17.6 million and \$5.1 million for the nine months ended September 30, 2011, and 2010, respectively, which are payable to our Manager under our management agreement. The increase in management fees is attributable to an increase in shareholders equity resulting from our follow-on common stock offerings in 2010 and 2011. This management fee and the relationship between the Company and the Manager are discussed further in our discussion of related party relationships.

Our general and administrative expenses include the estimated salary and bonus of our Controller, amortization of equity based compensation related to anticipated quarterly grants of our stock to our independent directors, payable subsequent to each calendar quarter, cash-based payments to our independent directors, derivative transaction fees, filing fees, and other miscellaneous general and administrative costs. These costs are generally fixed in nature and are generally not dependent on the size of the Company.

Our general and administrative expenses were approximately \$829,000 and \$885,000 for the three months ended September 30, 2011 and 2010, respectively.

Our general and administrative expenses were approximately \$2.9 million and \$2.8 million for the nine months ended September 30, 2011 and 2010, respectively.

## **Net Income and Return on Average Equity**

Our net income was \$82.2 million and \$27.6 million for the three months ended September 30, 2011 and 2010, respectively. Our annualized return on average equity was 17.79% and 19.71% for the three months ended September 30, 2011 and 2010, respectively. The increase in net income was primarily the result of an increase in our net interest income following our portfolio growth. The decrease in return on average equity was primarily the result of a decrease in asset yields of our investment portfolio.

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Our net income was \$210.3 million and \$62.8 million for the nine months ended September 30, 2011 and 2010, respectively. Our annualized return on average equity was 18.37% and 17.50% for the nine months ended September 30, 2011 and 2010, respectively. The increase in net income and return on average equity was primarily the result of an increase in our net interest income following our portfolio growth.

### **Liquidity and Capital Resources**

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

We currently believe that we have sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on borrowings and the payment of cash dividends as required for continued qualification as a REIT. We generally maintain liquidity to pay down borrowings under repurchase arrangements to reduce borrowing costs and otherwise efficiently manage our long-term investment capital. Because the level of these borrowings can be adjusted on a daily basis, the level of cash and cash equivalents carried on our balance sheet is significantly less important than our potential liquidity available under borrowing arrangements.

We held cash and cash equivalents of approximately \$56.9 million and \$20.4 million at September 30, 2011 and 2010, respectively. Our cash and cash equivalents increased due to normal fluctuations in cash balances related to the timing of principal and interest payments, repayments of debt, and asset purchases and sales.

Our operating activities provided net cash of approximately \$202.4 million and \$42.6 million for the nine month periods ended September 30, 2011 and 2010, respectively. The cash provided by operating activities increased due to the increase in net interest income earned by the portfolio which resulted from the increase in average interest earning assets of \$10.0 billion in investments at September 30, 2011 as compared to \$1.9 billion at September 30, 2010.

Our investing activities used net cash of \$8.7 billion and \$1.6 billion for the nine month periods ended September 30, 2011 and 2010, respectively. During the nine month period ended September 30, 2011 we utilized cash to purchase \$10.7 billion in securities which were offset by proceeds from asset sales of \$1.2 billion and principal payments of \$936.4 million. During the nine month period ended September 30, 2010 we utilized cash to purchase \$2.0 billion in securities and sold \$216.1 million and received principal payments of \$265.9 million. The increase in principal payments resulted from the larger portfolio at September 30, 2011 as compared to 2010.

Our financing activities for the nine months ended September 30, 2011 consisted of net proceeds from our March, June and August 2011 follow-on public offerings in which we raised approximately \$1.3 billion and from our repurchase agreements.

Our financing activities for the nine months ended September 30, 2010 consisted of net proceeds from our January and May 2010 follow-on public offerings in which we raised approximately \$342.0 million and from our repurchase agreements.

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The table below shows the allocation of our equity and debt-to-equity ratio as of September 30, 2011. The leverage on each class of assets may periodically exceed the stated ranges as we adjust our borrowings to obtain the best available source and minimize total interest expense while maintaining our overall portfolio leverage guidelines.

\$ in thousands	Agency	Non-Agency	CMBS	Unconsolidated Ventures	Total
Borrowings	9,044,073	2,114,019	1,023,753		12,181,845
Equity allocation	976,692	574,549	261,635	110,907	1,923,783
Debt / Equity Ratio	9.3	3.7	3.9		6.3
% of Total Equity	50.8 %	29.9 %	13.6 %	5.7 %	100.0 %

We enter into repurchase agreements with various counterparties to fund our purchases of MBS. The following table summarizes our total borrowings by type of investment as of September 30, 2011 and December 31, 2010:

\$ in thousands	September 30, 2011		December 31, 2010	
	Amount Outstanding	Weighted Average Interest Rate	Amount Outstanding	Weighted Average Interest Rate
Agency RMBS	9,044,073	0.29 %	3,483,440	0.33 %
Non-Agency RBS	2,114,019	1.51 %	459,979	1.76 %
CMBS	1,023,753	1.44 %	401,240	1.30 %
Total	12,181,845	0.60 %	4,344,659	0.57 %

As of September 30, 2011, the weighted average margin requirement, or the percentage amount by which the collateral value must exceed the loan amount, which we also refer to as the haircut, under our repurchase agreements for Agency RMBS was approximately 4.78% (weighted by borrowing amount), under our repurchase agreements for non-Agency RMBS was approximately 19.20% and under our repurchase agreements for CMBS was approximately 18.97%. Across our repurchase facilities for Agency RMBS, the haircuts range from a low of 3% to a high of 7%, for non-Agency RMBS range from a low of 10% to a high of 40% and for CMBS range from a low of 12% to a high of 30%. Our hedged cost of funds was approximately 1.56% and 0.89% as of September 30, 2011 and December 31, 2010, respectively. Declines in the value of our securities portfolio can trigger margin calls by our lenders under our repurchase agreements. An event of default or termination event would give some of our counterparties the option to terminate all repurchase transactions existing with us and require any amount due by us to the counterparties to be payable immediately.]

As discussed above under Market Conditions, the residential mortgage market in the United States has experienced difficult economic conditions including:

increased volatility of many financial assets, including agency securities and other high-quality RMBS assets, due to potential security liquidations;

increased volatility and deterioration in the broader residential mortgage and RMBS markets; and

significant disruption in financing of RMBS.

If these conditions persist, then our lenders may be forced to exit the repurchase market, become insolvent or further tighten lending standards or increase the amount of required equity capital or haircut, any of which could make it more difficult or costly for us to obtain financing. In addition, because Fannie Mae and Freddie Mac are in conservatorship of the U.S. government, if the U.S. credit rating is downgraded, it may



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impact the credit risk associated with Agency RMBS and other assets, and, therefore, decrease the value of the Agency RMBS, non-Agency RBMS and CMBS in our portfolio, which could cause our repurchase counterparties to make margin calls on our borrowings and swaps, if our collateral is insufficient to cover the debt secured by our assets.

Effective as of August 27, 2010, we implemented a dividend reinvestment and stock purchase plan (the "DRIP"), pursuant to which we registered and reserved for issuance 2,000,000 shares of our common stock. Under the terms of the DRIP, shareholders who participate in the DRIP may purchase shares of our common stock directly from us, in cash investments up to \$10,000. At our sole discretion, we may accept optional cash investments in

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excess of \$10,000 per month, which may qualify for a discount from the market price of 0% to 3%. The DRIP participants may also automatically reinvest all or a portion of their dividends for additional shares of our stock. We expect to use the proceeds from any dividend reinvestments or stock purchases for general corporate purposes. During the nine months ended September 30, 2011, we issued a total of 6,201 common shares pursuant to the plan.

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

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

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

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

### *Forward-Looking Statements Regarding Liquidity*

Based upon our current portfolio, leverage rate and available borrowing arrangements, we believe that the net proceeds of our common equity offerings, combined with cash flow from operations and available borrowing capacity, will be sufficient to enable us to meet anticipated short-term (one year or less) liquidity requirements to fund our investment activities, pay fees under our management agreement, fund our distributions to shareholders and for other general corporate expenses.

Our ability to meet our long-term (greater than one year) liquidity and capital resource requirements will be subject to obtaining additional debt financing and equity capital. We may increase our capital resources by obtaining long-term credit facilities or through public or private offerings of equity or debt securities, possibly including classes of preferred stock, common stock, and senior or subordinated notes. Such financing will depend on market conditions for capital raises and our ability to invest such offering proceeds. If we are unable to renew, replace or expand our sources of financing on substantially similar terms, it may have an adverse effect on our business and results of operations.

## **Contractual Obligations**

On July 1, 2009, we entered into an agreement with our Manager pursuant to which our Manager is entitled to receive a management fee and the reimbursement of certain expenses, which was amended on May 24, 2011. The management fee will be calculated and payable quarterly in arrears in an amount equal to 1.50% of our shareholders' equity, per annum, calculated and payable quarterly in arrears. Our Manager uses the proceeds from its management fee in part to pay compensation to its officers and personnel who, notwithstanding that certain of

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those individuals are also our officers, receive no cash compensation directly from us. We are required to reimburse our Manager for operating expenses related to us incurred by our Manager, including certain salary expenses and other expenses relating to legal, accounting, due diligence and other services. Expense reimbursements to our Manager are made in cash on a monthly basis following the end of each month. Our reimbursement obligation is not subject to any dollar limitation. Refer to Note 8 Related Party Transactions for details of our reimbursements to our Manager.

**Contractual Commitments**

As of September 30, 2011, we had the following contractual commitments and commercial obligations:

\$ in thousands	Total	Payments Due by Period			
		Less than 1 year	1-3 years	3-5 years	After 5 years
Repurchase agreements	12,181,845	12,181,845			
Invesco PPIP Fund investment	4,675		4,675		
<b>Total contractual obligations</b>	<b>12,186,520</b>	<b>12,181,845</b>	<b>4,675</b>		

As of September 30, 2011, we have approximately \$6.7 million in contractual interest payments related to our repurchase agreements.

**Off-Balance Sheet Arrangements**

We committed to invest up to \$100.0 million in the Invesco PPIP Fund, which, in turn, invests in our target assets. As of September 30, 2011 and 2010, approximately \$95.3 million and \$55.0 million of the commitment has been called, respectively.

We also utilize credit derivatives, such as credit default swaps, to provide credit event protection based on a financial index or specific security in exchange for receiving a fixed-rate fee or premium over the term of the contract. These instruments enable us to synthetically assume the credit risk of a reference security, portfolio of securities or index of securities. The counterparty pays a premium to us and we agree to make a payment to compensate the counterparty for losses upon the occurrence of a specified credit event.

Although contract-specific, credit events generally include bankruptcy, failure to pay, restructuring, obligation acceleration, obligation default, or repudiation/moratorium. Upon the occurrence of a defined credit event, the difference between the value of the reference obligation and the CDS's notional amount is recorded as realized loss in the statement of operations.

Our only CDS contract was entered into on December 31, 2010 with a \$150.0 million notional balance where we sold protection on a specific pool of non-Agency RMBS that exceed a specified loss limit of 25% for a stated fixed rate fee of 3%. Our maximum exposure is the unpaid principal balance of the underlying RMBS that exceeds the specified loss limit. We posted cash collateral to secure potential loss payments of \$18.5 million as of September 30, 2011 compared to \$19.8 million as of June 30, 2011. The notional amount of the CDS at September 30, 2011 is \$120.6 million compared to \$128.8 million at June 30, 2011, and we estimate the fair market value of the CDS is approximately \$1.6 million at September 30, 2011 compared to \$1.7 million at June 30, 2011. As of September 30, 2011, we have not made any payments related to the CDS contract.

**Shareholders Equity**

During the quarter ended September 30, 2011, we issued 1,389,200 shares of common stock at an average price of \$18.90 under the DSPP with total proceeds to us of approximately \$26.1 million, net of issuance costs.

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On August 23, 2011, we completed a follow-on public offering of 20,000,000 shares of common stock at \$18.37 per share. Net proceeds to us were approximately \$362.2 million, net of issuance costs of approximately \$5.2 million.

### **Unrealized Gains and Losses**

Since we account for our investment securities as available-for-sale, unrealized fluctuations in market values of assets do not impact our U.S. GAAP income but rather are reflected on our balance sheet by changing the carrying value of the asset and shareholders' equity under Accumulated Other Comprehensive Income (Loss). In addition, unrealized fluctuations in market values of our cash flow hedges that qualify for hedge accounting are also reflected in Accumulated Other Comprehensive Income (Loss). For the three months ended September 30, 2011 and 2010, net unrealized loss included in shareholders' equity was \$300.7 million and a net unrealized gain included in shareholders' equity was \$10.1 million, respectively.

For the nine months ended September 30, 2011 and 2010, net unrealized loss included in shareholders' equity was \$416.7 million and a net unrealized gain included in shareholders' equity was \$3.8 million, respectively.

The increase in net unrealized losses is primarily attributable to changes in the market values of our cash flow hedges that qualify for hedge accounting. Refer to Note 3 Mortgage-Backed Securities and Note 6 Derivative and Hedging Activities for more details on the unrealized gains and losses in both our investment securities and our cash flow hedges.

As a result of this mark-to-market accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used historical amortized cost accounting. As a result, comparisons with companies that use historical cost accounting for some or all of their balance sheet may not be meaningful.

### **Share-Based Compensation**

We established the 2009 Equity Incentive Plan for grants of restricted common stock and other equity based awards to our independent, non-executive directors, and to the officers and employees of the Manager (the Incentive Plan). Under the Incentive Plan, a total of 1,000,000 shares are currently reserved for issuance. Unless terminated earlier, the Incentive Plan will terminate in 2019, but will continue to govern the unexpired awards. Effective July 1, 2011, our three independent, non-executive directors are each eligible to receive \$50,000 in restricted common stock annually. For the three months ended September 30, 2011 and 2010, we recognized compensation expense of approximately \$38,000 and \$19,000 and issued 1,722 and 915 shares, respectively, of restricted stock to our independent, non-executive directors pursuant to the Incentive Plan. For the nine months ended September 30, 2011 and 2010, we recognized compensation expense of approximately \$105,000 and \$71,000 and issued 4,617 and 2,670 shares, respectively, of restricted stock to our independent, non-executive directors pursuant to the Incentive Plan. The number of shares issued was determined based on the closing price of our common stock on the NYSE on the actual date of grant.

### **Dividends**

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

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On September 8, 2011, we declared a dividend of \$0.80 per share of common stock. The dividend was paid on October 27, 2011 to shareholders of record as of the close of business on September 19, 2011.

### **Inflation**

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

### **Other Matters**

We calculate that at least 75% of our assets were qualified REIT assets, as defined in the Internal Revenue Code of 1986, as amended (the Code) for the period ended September 30, 2011. We also calculate that our revenue qualifies for the 75% source of income test and for the 95% source of income test rules for the period ended September 30, 2011. Consequently, we met the REIT income and asset test as of September 30, 2011. We also met all REIT requirements regarding the ownership of our common stock and the distribution of our net income as of September 30, 2011. Therefore, as of September 30, 2011, we believe that we qualified as a REIT under the Code.

At all times, we intend to conduct our business so that neither we nor our operating partnership nor the subsidiaries of our operating partnership are required to register as an investment company under the 1940 Act. If we were required to register as an investment company, then our use of leverage would be substantially reduced. Because we are a holding company that conducts our business through our operating partnership and the operating partnership's wholly-owned or majority-owned subsidiaries, the securities issued by these subsidiaries that are excepted from the definition of investment company under Section 3(c)(1) or Section 3(c)(7) of the 1940 Act, together with any other investment securities the operating partnership may own, may not have a combined value in excess of 40% of the value of the operating partnership's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis, which we refer to as the 40% test. This requirement limits the types of businesses in which we may engage through our subsidiaries. In addition, we believe neither the company nor the operating partnership are considered an investment company under Section 3(a)(1)(A) of the 1940 Act because they do not engage primarily or hold themselves out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through the operating partnership's wholly-owned or majority-owned subsidiaries, the company and the operating partnership are primarily engaged in the non-investment company businesses of these subsidiaries. IAS Asset I LLC and certain of the operating partnership's other subsidiaries that we may form in the future rely upon the exclusion from the definition of investment company under the 1940 Act provided by Section 3(c)(5)(C) of the 1940 Act, which is available for entities primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. This exclusion generally requires that at least 55% of each subsidiary's portfolio be comprised of qualifying assets and at least 80% be comprised of qualifying assets and real estate-related assets (and no more than 20% comprised of miscellaneous assets). Qualifying assets for this purpose include mortgage loans fully secured by real estate and other assets, such as whole pool Agency and non-Agency RMBS, that the SEC or its staff in various no-action letters has determined are the functional equivalent of mortgage loans fully secured by real estate. We treat as real estate-related assets CMBS, debt and equity securities of companies primarily engaged in real estate businesses, Agency partial pool certificates and securities issued by pass-through entities of which substantially all of the assets consist of qualifying assets and/or real estate-related assets. Additionally, unless certain mortgage securities represent all the certificates issued with respect to an underlying pool of mortgages, the MBS may be treated as securities separate from the underlying mortgage loans and, thus, may not be considered qualifying interests for purposes of the 55% requirement. We calculate that as of September 30, 2011, we conducted our business so as not to be regulated as an investment company under the 1940 Act.

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### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

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

#### **Interest Rate Risk**

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

#### **Interest Rate Effect on Net Interest Income**

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

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

#### **Interest Rate Effects on Fair Value**

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

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

The impact of changing interest rates on fair value can change significantly when interest rates change materially. Therefore, the volatility in the fair value of our assets could increase significantly in the event interest rates change materially. In addition, other factors impact the fair value of our interest rate-sensitive investments and hedging instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, changes in actual interest rates may have a material adverse effect on us.

**Table of Contents****Prepayment Risk**

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

**Extension Risk**

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

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

**Market Risk***Market Value Risk*

Our available-for-sale securities are reflected at their estimated fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income pursuant to ASC Topic 320. The estimated fair value of these securities fluctuates primarily due to changes in interest rates and other factors. Generally, in a rising interest rate environment, the estimated fair value of these securities would be expected to decrease; conversely, in a decreasing interest rate environment, the estimated fair value of these securities would be expected to increase.

The sensitivity analysis table presented below shows the estimated impact of an instantaneous parallel shift in the yield curve, up and down 50 and 100 basis points, on the market value of our interest rate-sensitive investments and net interest income, at September 30, 2011, assuming a static portfolio. When evaluating the impact of changes in interest rates, prepayment assumptions and principal reinvestment rates are adjusted based on our Manager's expectations. The analysis presented utilized assumptions, models and estimates of our Manager based on our Manager's judgment and experience.

Change in Interest Rates	Percentage Change in Projected	Percentage Change in Projected
	Net Interest Income	Portfolio Value
+1.00%	9.70 %	(0.73)%
+0.50%	15.79 %	(0.23)%
-0.50%	(20.09)%	(0.17)%
-1.00%	(38.69)%	(0.66)%

*Real Estate Risk*

Residential and commercial property values are subject to volatility and may be affected adversely by a number of factors, including, but not limited to: national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors); local real estate conditions (such as the supply of housing stock); changes or continued weakness in specific industry segments; construction quality, age and design;

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demographic factors; and retroactive changes to building or similar codes. In addition, decreases in property values reduce the value of the collateral and the potential proceeds available to a borrower to repay our loans, which could also cause us to suffer losses.

### **Credit Risk**

We believe that our investment strategy will generally keep our credit losses and financing costs low. However, we retain the risk of potential credit losses on all of the residential and commercial mortgage loans, as well as the loans underlying the non-Agency RMBS and CMBS in our portfolio. We seek to manage this risk through our pre-acquisition due diligence process and through the use of non-recourse financing, which limits our exposure to credit losses to the specific pool of mortgages that are subject to the non-recourse financing. In addition, with respect to any particular asset, our Manager's investment team evaluates, among other things, relative valuation, supply and demand trends, shape of yield curves, prepayment rates, delinquency and default rates, recovery of various sectors and vintage of collateral.

### **Risk Management**

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

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

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

using hedging instruments, primarily interest rate swap agreements but also financial futures, options, interest rate cap agreements, floors and forward sales to adjust the interest rate sensitivity of our target assets and our borrowings; and

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

### **ITEM 4. CONTROLS AND PROCEDURES.**

Our management is responsible for establishing and maintaining disclosure controls and procedures that are designed to ensure that information we are required to disclose in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include controls and procedures designed to ensure that the required information is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure.

We have evaluated, with the participation of our principal executive officer and principal financial officer, the effectiveness of our disclosure controls and procedures as of September 30, 2011. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon our evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.



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No change occurred in our internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) of the Exchange Act) during the nine months ended September 30, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**Table of Contents****PART II OTHER INFORMATION****ITEM 1. 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 September 30, 2011, we were not involved in any such legal proceedings.

**ITEM 1A. RISK FACTORS.**

Other than the risk factor set forth below, there were no material changes during the period covered by this report to the risk factors previously disclosed in our annual report on Form 10-K for the year ended December 31, 2010, as filed with the SEC on March 14, 2011. Additional risks not presently known, or that we currently deem immaterial, also may have a material adverse affect on our business, financial condition and results of operation.

*Maintenance of our 1940 Act exemption imposes limits on our operations; Failure to maintain an exemption could have a material negative impact on our operations.*

The company conducts its operations so that neither it, nor the operating partnership nor the subsidiaries of the operating partnership are required to register as an investment company under the 1940 Act. Because the company is a holding company that conducts its businesses through the operating partnership and the operating partnership's wholly-owned or majority-owned subsidiaries, the securities issued by these subsidiaries that are excepted from the definition of investment company under Section 3(c)(1) or Section 3(c)(7) of the 1940 Act, together with any other investment securities the operating partnership may own, may not have a combined value in excess of 40% of the value of the operating partnership's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis which we refer to as the 40% test. This requirement limits the types of businesses in which we may engage in through our subsidiaries. IAS Asset I LLC and certain of the operating partnership's other subsidiaries that we may form in the future intend to rely upon the exemption from registration as an investment company under the 1940 Act pursuant to 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 exemption 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). Qualifying assets for this purpose include mortgage loans and other assets, such as whole pool Agency and non-Agency RMBS, that the SEC staff in various no-action letters has determined are the functional equivalent of mortgage loans for the purposes of the 1940 Act. We treat as real estate-related assets CMBS, debt and equity securities of companies primarily engaged in real estate businesses, agency partial pool certificates and securities issued by pass-through entities of which substantially all of the assets consist of qualifying assets and/or real estate-related assets. IAS Asset I LLC invests in the Invesco PPIP Fund. We treat IAS Asset I LLC's investment in the Invesco PPIP Fund as a real estate-related asset for purposes of the Section 3(c)(5)(C) analysis. As a result, IAS Asset I LLC can invest no more than 45% of its assets in the Invesco PPIP Fund and other real estate-related assets. We note that the SEC has not provided any guidance on the treatment of interests in PPIFs as real estate-related assets and any such guidance may require us to change our strategy. We may need to adjust IAS Asset I LLC's assets and strategy in order for it to continue to rely on Section 3(c)(5)(C) for its 1940 Act exemption. Any such adjustment in IAS Asset I LLC's assets or strategy is not expected to have a material adverse effect on our business or strategy. Although we monitor our portfolio periodically and prior to each investment acquisition, there can be no assurance that we will be able to maintain this exemption from registration for IAS Asset I LLC and such other subsidiaries that we may form in the future intending to rely on Section 3(c)(5)(C) of the 40 Act. The legacy securities PPIF formed and managed by our Manager or one of its affiliates relies on Section 3(c)(7) for its 1940 Act exemption.

We may in the future organize one or more subsidiaries that seek to rely on the 1940 Act exemption provided to certain structured financing vehicles by Rule 3a-7. Any such subsidiary would need to be structured to comply with any guidance that may be issued by the SEC staff on the restrictions contained in Rule 3a-7. The company expects that the aggregate value of the operating partnership's interests in subsidiaries that seek to rely on Rule 3a-7 will comprise less than 20% of the operating partnership's (and, therefore, the company's) total assets on an unconsolidated basis.

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Qualification for exemption from registration under the 1940 Act will limit our ability to make certain investments. For example, these restrictions will limit the ability of our subsidiaries to invest directly in mortgage-backed securities that represent less than the entire ownership in a pool of mortgage loans, debt and equity tranches of securitizations and certain asset-backed securities and real estate companies or in assets not related to real estate.

There can be no assurance that the laws and regulations governing the 1940 Act status of REITs, including the SEC staff providing more specific or different guidance regarding these exemptions, will not change in a manner that adversely affects our operations. The SEC recently solicited public comment on a wide range of issues relating to Section 3(c)(5)(C) and Rule 3a-7 of the 1940 Act, including the nature of the assets that qualify for purposes of the exemption and whether mortgage REITs should be regulated in a manner similar to investment companies. To the extent that the SEC staff provides more specific guidance regarding any of the matters bearing upon such exclusions, we may be required to adjust our strategy accordingly. Any additional guidance from the SEC staff could provide additional flexibility to us, or it could further inhibit our ability to pursue the strategies we have chosen. If we, the operating partnership or its subsidiaries fail to maintain an exception or exemption from the 1940 Act, we could, among other things, be required either to (a) change 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 which could negatively affect the value of our common stock, the sustainability of our business model, and our ability to make distributions which could have an adverse effect on our business and the market price for our shares of common stock.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

None.

**ITEM 4. RESERVED**

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**ITEM 5. OTHER INFORMATION.**

None.

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**SIGNATURES**

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

INVESCO MORTGAGE CAPITAL INC.

November 4, 2011

By: /s/ Richard J. King  
Richard J. King  
President and Chief Executive Officer

November 4, 2011

By: /s/ Donald R. Ramon  
Donald R. Ramon  
Chief Financial Officer

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<b>Exhibit No.</b>	<b>Description</b>
3.1	Articles of Amendment and Restatement of Invesco Mortgage Capital Inc., incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q, filed with the Securities and Exchange Commission on August 12, 2009.
3.2	Amended and Restated Bylaws of Invesco Mortgage Capital Inc., incorporated by reference to Exhibit 3.2 to Amendment No. 8 to our Registration Statement on Form S-11, filed with the Securities and Exchange Commission on June 18, 2009.
31.1	Certification of Richard J. King pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Donald R. Ramon pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Richard J. King pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Donald R. Ramon pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following series of unaudited XBRL-formatted documents are collectively included herewith as Exhibit 101. The financial information is extracted from Invesco Mortgage Capital Inc.'s unaudited consolidated interim financial statements and notes that are included in this Form 10-Q Report.
	101.INS XBRL Instance Document
	101.SCH XBRL Taxonomy Extension Schema Document
	101.CAL XBRL Taxonomy Calculation Linkbase Document
	101.LAB XBRL Taxonomy Label Linkbase Document
	101.PRE XBRL Taxonomy Presentation Linkbase Document
	101.DEF XBRL Taxonomy Definition Linkbase Document