



Western Asset
Mortgage Capital Corp.



2022 Annual Report

www.westernassetmcc.com

Western Asset Mortgage Capital Corporation

Letter to Stockholders

Dear Fellow Stockholders:

During 2022 we continued executing upon our plan to focus on residential real estate and transition out of commercial real estate investments, a strategy that we had previously announced in December 2021. In addition, over the course of last year and during the first quarter of 2023, we have taken a series of proactive steps to deleverage, build liquidity and strengthen our balance sheet.

- In 2022, we acquired \$412 million of Residential Whole Loans. Our portfolio continues to perform well. Delinquencies over 30 days have declined to just 0.92% of the total portfolio, reinforcing the effectiveness of our credit underwriting standards.
- In the first and third quarters of 2022, we completed two securitizations totaling \$834 million of Residential Whole Loans, securing \$751 million of long-term fixed rate financing, which is essential to our strategy, particularly in light of the rapid rise in interest rates last year.
- In February 2022, we sold the unencumbered hotel property we foreclosed on in 2021, receiving \$36 million in net proceeds and recording a gain on sale of the property of approximately \$9 million.
- During the year, we received \$216 million from the repayment or paydown of Residential Whole Loans and \$21 million of Commercial Whole Loans as well as \$56 million from the sale of Non-Agency RMBS, CMBS and other securities.
- In July, we implemented a 1-for-10 reverse stock split of our outstanding shares of common stock.
- We repurchased \$12 million aggregate principal amount of our outstanding 6.75% Convertible Senior Unsecured Notes due in 2022 and, in October, we redeemed the remaining \$26 million at maturity.
- In the fall, we amended and extended the maturity dates of our Residential Whole Loan and Commercial Whole Loan Credit Facilities to October 25, 2023, and November 3, 2023, respectively.
- Furthermore, in February 2023, we sold our one nonperforming Commercial Whole Loan to an unaffiliated third party for \$8.8 million, which was equal to the fair value of the loan at December 31, 2022.

At the same time, 2022 was a challenging year for the mortgage REIT sector and for the Company. We faced a number of headwinds, including record high interest volatility, fluctuating asset values, wider credit spreads, and the underperformance of one of our larger commercial real estate investments. The financial results we share with you today reflect these difficulties.

In March, we made the decision to reset our quarterly dividend to better reflect our near-term earnings power as we reposition the portfolio. As we make further progress, we will reassess the level of the dividend based on a number of factors, including the future earnings power of the portfolio and the expected level of taxable income.

Against the backdrop of a challenging market, we have not seen our stock price reflect the progress we have made on our strategic plan. Last August, we therefore embarked upon a process to review strategic alternatives for the Company as the best path forward towards unlocking shareholder value. The market environment for mortgage REITs over the last several quarters has been remarkably challenging, with record



levels of interest rate volatility and increasing risks to economic growth. This has added complexity to our exploration of strategic partners. We remain committed to concluding this process in a satisfactory manner and we will provide an update at the appropriate time. In the meantime, we will continue to run the Company in a manner that is consistent with our goal of optimizing the value of our assets and maintaining stable earnings.

We have included additional commentary from our manager on our current investment outlook and our portfolio, which follows below. We encourage you to review the financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2022. In particular, please note the risk factors related to our business contained within the Annual Report.

In closing, as fellow stockholders, we are keenly focused on preserving and growing the value of the portfolio. We are confident that we are taking the right steps to strengthen our balance sheet and improve the earnings power of the portfolio. We believe that our progress on these steps should be reflected in our stock price over time. As always, we remain committed to generating consistent earnings that support an attractive dividend.

Sincerely,

Bonnie M. Wongtrakool
Chief Executive Officer
May 1, 2023

2023 Outlook

by Western Asset Management Company, LLC – May 1, 2023

Our view as we entered 2023 was that the Federal Reserve would continue its restrictive monetary policy and interest rate hikes until there was clear evidence that inflation was abating. We did believe that inflation would begin to ease in 2023 as supply-chain bottlenecks diminished, commodity prices declined from their peak levels and the labor market became more balanced. We anticipated that the U.S. economy would continue to grow, albeit at a slow pace, but were cognizant that the risks of a recession had increased, given the Federal Reserve's continued hawkish stance.

Added to this macroeconomic backdrop was that in the span of just two months, we've experienced three of the four largest bank failures in the history of the United States, which has created additional volatility in both the equity and fixed-income markets and has caused credit spreads to widen across nearly all major asset classes, with some sectors being impacted more than others. As such, while we believe that credit sectors remain attractive, both on a relative value and historical basis, the near-term outlook remains clouded by the macroeconomic uncertainty that exists in the minds of institutional and retail investors.

During the first quarter of 2023, WMC's residential investments experienced an increase in value versus the prior quarter. We believe this is a reflection of the quality of the residential whole-loan portfolio, which continues to perform well. Of the nearly 3,000 mortgages in the Company's portfolio, less than 1% are more than 30 days delinquent at quarter-end, an improvement from one year ago. This underscores the effectiveness of our credit underwriting standards which focus on high-quality borrowers who have meaningful equity in their homes.

Our view of the overall housing market is that after booming during the last couple of years, home prices have begun to stall and even decline in certain markets under the pressure of higher mortgage rates and the lack of affordability. The housing market surge during the 2020 and 2021 was primarily due to inadequate supply relative to increased demand. More recently, new supply has become available and demand has cooled in response to higher interest rates, creating a more balanced market. Given the potential for a recession, we believe that there will likely be continued downward pressure on home prices.

However, while housing is expected to cool, we do not see a significant risk of widespread defaults or home price correction, particularly as it relates to the Company's portfolio. This assessment is mainly due to our disciplined underwriting standards that have remained high during this cycle and our approach of targeting high quality borrowers. Additionally, we expect the volatility in interest rates and spreads to decline as we get more clarity on the conclusion of the Federal Reserve's tightening cycle. Therefore, we believe that spread normalization, combined with high carry, could provide upside value to the Company's residential holdings.

Meanwhile, the overall market sentiment for commercial real estate credit remains challenged. We see three primary reasons for this:

First, the Federal Reserve rate hikes have resulted in higher mortgage rates, negatively impacting cap rates and collateral valuations as equity investors adjust to the higher capital costs. Second, the recent banking industry stresses have impacted credit spreads broadly and over time are expected to drive further reductions in real estate credit availability and a tightening of underwriting standards. And lastly, concerns over office values have escalated as some notable high-profile defaults have occurred. While the multifamily housing, industrial, hospitality and retail sectors have all recovered and, in many cases, are now outperforming pre-COVID levels, the office market faces a highly uncertain future with significant questions about the long-term viability of lower-quality properties.

We believe that the Company's current commercial mortgage portfolio—while not immune to this negative market sentiment—is unique and well-positioned to withstand a deteriorating economic environment. During the first quarter of 2023, as spreads continued to widen across the commercial mortgage credit sector, the Company's commercial holdings were only modestly impacted.

The Company's commercial investments consist primarily of loans which are backed by class-A retail and hotel properties that cater to leisure travelers, and we continue to see positive operating momentum at a number of these properties. These are generally high-quality assets with strong equity sponsors, so we believe that their collateral values have not been materially or permanently impaired. In addition, the Company's exposure to office buildings is minimal within its total commercial mortgage holdings.

In conclusion, we believe that the Company is well-positioned to benefit from its residential holdings as well as a normalization of credit spreads in most sectors of the commercial real estate market. We remain focused on optimizing the recovery values in the Company's commercial portfolio and intend to use proceeds from exits and payoffs to reduce recourse debt levels, maintain sufficient liquidity and to opportunistically reinvest into new target assets that continue to offer attractive risk-adjusted returns.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2022

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: 001-35543

WESTERN ASSET MORTGAGE CAPITAL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

27-0298092

(I.R.S. Employer Identification No.)



Western Asset Mortgage Capital Corporation
385 East Colorado Boulevard,
Pasadena, California 91101
(Address of principal executive offices)
(626) 844-9400

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common Stock, \$0.01 par value	WMC	New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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

Indicate by check mark whether the Registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements.

Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to §240.10D-1(b).

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

The aggregate market value of the registrant's common stock held by non-affiliates was \$72,311,113 based on the closing sales price on the New York Stock Exchange on June 30, 2022.

On March 10, 2023, the registrant had a total of 6,038,012 shares of common stock outstanding.

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FORWARD-LOOKING INFORMATION

The Company makes forward-looking statements herein and will make forward-looking statements in future filings with the Securities and Exchange Commission (the “SEC”), press releases or other written or oral communications within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). For these statements, the Company claims the protections of the safe harbor for forward-looking statements contained in such sections. Forward-looking statements are subject to substantial risks and uncertainties, many of which are difficult to predict and are generally beyond the Company’s control.

These forward-looking statements include information about possible or assumed future results of the Company’s business, financial condition, liquidity, results of operations, plans and objectives. When the Company uses the words “believe,” “expect,” “anticipate,” “estimate,” “plan,” “continue,” “intend,” “should,” “may” or similar expressions, the Company intends to identify forward-looking statements. Statements regarding the following subjects, among others, may be forward-looking: market trends in the Company’s industry, interest rates, real estate values, the debt securities markets, the U.S. housing and the U.S. and foreign commercial real estate markets or the general economy or the market for residential and/or commercial mortgage loans; the Company’s business and investment strategy; the Company’s projected operating results; changes in interest rates and the market value of the Company’s target assets; credit risks; servicing-related risks, including those associated with foreclosure and liquidation; the state of the U.S. and to a lesser extent, international economy generally or in specific geographic regions; economic trends and economic recoveries; the Company’s ability to obtain and maintain financing arrangements, including under the Company’s repurchase agreements, a form of secured financing, and securitizations; the current potential return dynamics available in residential mortgage-backed securities (“RMBS”), and commercial mortgage-backed securities (“CMBS” and collectively with RMBS, “MBS”); the level of government involvement in the U.S. mortgage market; the anticipated default rates on CMBS and Commercial Loans; the loss severity on Non-Agency MBS; the general volatility of the securities markets in which the Company participates; changes in the value of the Company’s assets; the Company’s expected portfolio of assets; the Company’s expected investment and underwriting process; interest rate mismatches between the Company’s target assets and any borrowings used to fund such assets; changes in prepayment rates on the Company’s target assets; effects of hedging instruments on the Company’s target assets; rates of default or decreased recovery rates on the Company’s target assets; the degree to which the Company’s hedging strategies may or may not protect the Company from interest rate volatility; the impact of and changes in governmental regulations, tax law and rates, accounting guidance and similar matters; the Company’s ability to maintain the Company’s qualification as a real estate investment trust for U.S. federal income tax purposes; the Company’s ability to maintain its exemption from registration under the Investment Company Act of 1940, as amended (the “1940 Act”); the availability of opportunities to acquire Agency RMBS, Non-Agency RMBS, CMBS, Residential and Commercial Whole Loans, Residential and Commercial Bridge Loans and other mortgage assets; the availability of qualified personnel; estimates relating to the Company’s ability to make distributions to its stockholders in the future; the Company’s understanding of its competition; outcome and impact of the strategic alternatives review process as announced in August 2022; the uncertainty and economic impact of pandemics, epidemics, or other public health emergencies, such as the ongoing effects of the COVID-19 pandemic; and the Manager’s expectations regarding the ongoing COVID-19 recovery.

The forward-looking statements are based on the Company’s beliefs, assumptions and expectations of its future performance, taking into account all information currently available to it. Forward-looking statements are not predictions of future events. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to the Company. Some of these factors, are described in Item 1A - “Risk Factors” and Item 7 - “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this annual report on Form 10-K. These and other risks, uncertainties and factors, including those described in the annual, quarterly and current reports that the Company files with the SEC, could cause its actual results to differ materially from those included in any forward-looking statements the Company makes. All forward-looking statements speak only as of the date they are made. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect the Company. Except as required by law, the Company is not obligated to, and does not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I

ITEM 1. BUSINESS

Our Company

Western Asset Mortgage Capital Corporation, a Delaware corporation, and its subsidiaries (the “Company” unless otherwise indicated or except where the context otherwise requires “we,” “us” or “our”) commenced operations in May 2012, focused on investing in, financing and managing a portfolio of real estate related securities, whole loans and other financial assets, which we collectively refer to as our target assets. We are externally managed by Western Asset Management Company, LLC (our “Manager”) pursuant to the terms of a management agreement. We conduct our operations to qualify and be taxed as a real estate investment trust, or REIT, for U.S. federal income tax purposes. Accordingly, we generally will not be subject to U.S. federal income taxes on our taxable income that we distribute currently to our stockholders as long as we maintain our intended qualification as a REIT. However, certain activities that we may perform may cause us to earn income which will not be qualifying income for REIT purposes. We have designated a subsidiary as a taxable REIT subsidiary, or TRS, to engage in such activities. We also intend to operate our business in a manner that permits us to maintain our exemption from registration under the 1940 Act. Our common stock is traded on the New York Stock Exchange, or the NYSE, under the symbol “WMC.”

Our objective is to provide attractive risk adjusted returns to our stockholders primarily through an attractive dividend, which we intend to support with sustainable distributable earnings (which we previously referred to as core earnings), as well as the potential for higher returns through capital appreciation. Our investment strategy is based on our Manager’s perspective of which mix of our target assets it believes provides us with the best risk-reward opportunities at any given time. We also deploy leverage as part of our investment strategy to increase potential returns.

Our Manager

We are externally managed and advised by our Manager, an SEC-registered investment advisor and a wholly-owned subsidiary of Franklin Resources, Inc. (“Franklin”), headquartered in Pasadena, California, that specializes in fixed-income asset management. From offices in Pasadena, London, Melbourne, New York, São Paulo, Singapore, Tokyo, and Zurich, our Manager’s 746 employees provide investment services for a wide variety of global clients, including mutual funds, corporate, public, insurance, health care, union organizations and charitable foundations. In addition, two of our directors, James W. Hirschmann III and Bonnie M. Wongtrakool, are also employees of our Manager. Our Manager is responsible for, among other duties: (i) performing all of our day-to-day functions; (ii) determining investment criteria in conjunction with our Board of Directors; (iii) sourcing, analyzing and executing investments, asset sales and financings; (iv) performing asset management duties; and (v) performing financial and accounting management.

Our Competitive Advantages

Our competitive advantages in the marketplace stems from our relationship with our Manager. As of December 31, 2022, our Manager had approximately \$395 billion in assets under management. Our Manager’s scale makes it an important trading partner for many of the largest broker-dealers and banks, which provides our investment team the ability to source real estate related opportunities directly from originators as well as access attractive financing.

Our Investment Strategy

Our Manager’s investment philosophy, which developed from a singular focus in fixed-income asset management over a variety of credit cycles and conditions, is to provide clients with a long-term value-oriented portfolio. We benefit from the breadth and depth of our Manager’s overall investment philosophy, which focuses on a macroeconomic analysis as well as an in-depth analysis of individual assets and their relative value. In making investment decisions on our behalf, our Manager seeks to identify assets across the broad mortgage universe with attractive risk adjusted returns, which incorporates its view on the outlook for the mortgage markets, including; relative valuation, supply and demand trends, the level of interest rates, the shape of the yield curve, prepayment rates, financing and liquidity, residential real estate prices, delinquencies, default rates, recovery of various segments of the economy and vintage of collateral, subject to maintaining our REIT qualification and our exemption from registration under the 1940 Act.

In December 2021, we announced that our investment strategy will focus on residential real estate related investments, including but not limited to non-qualified mortgage loans, Non-Agency RMBS, and other related investments. We believe this focus will allow us to address attractive market opportunities while maintaining alignment with our Manager’s core competencies. We are continuing to transition out of the commercial investments in our portfolio, though we may from time to time make commercial investments on an opportunistic basis.

Our Target Assets

Residential Whole Loans — Residential Whole Loans are mortgages secured by single family residences held directly by us or through consolidated trusts with us holding the beneficial interest in the trusts. Our Residential Whole Loans are mainly adjustable rate mortgages that do not qualify for the Consumer Finance Protection Bureau’s (or CFPB) safe harbor provision for “qualified mortgages” (“Non-QM mortgages”). Our Manager’s review, relating to Non-QM mortgages, includes an analysis of the loan originator’s procedures and documentation for compliance with Ability to Repay requirements. As discussed in Note 7, “Financings” to the consolidated financial statements contained in this Annual Report on Form 10-K, we have and may continue

to securitize whole loan interests, selling more senior interests in the pool of loans and retaining residual portions. The characteristics of our Residential Whole Loans may vary going forward.

Non-Agency RMBS — RMBS that are not guaranteed by a U.S. Government agency or U.S. Government-sponsored entity. The mortgage loan collateral for Non-Agency RMBS consists of residential mortgage loans that do not generally conform to underwriting guidelines issued by a U.S. Government agency or U.S. Government-sponsored entity due to certain factors, including mortgage balances in excess of Agency underwriting guidelines, borrower characteristics, loan characteristics and/or level of documentation, and therefore are not issued or guaranteed by a U.S. Government agency or U.S. Government-sponsored entity. The mortgage loan collateral may be classified as subprime, Alternative-A, or prime depending on the borrower’s credit rating and the underlying level of documentation. Non-Agency RMBS collateral may also include re-performing loans, which are conventional mortgage loans that were current at the time of the securitization, but had been delinquent in the past. Non-Agency RMBS may be secured by fixed-rate mortgages, adjustable-rate mortgages, or hybrid adjustable-rate mortgages.

Agency RMBS — Agency RMBS, which are RMBS for which the principal and interest payments are guaranteed by a U.S. Government agency, such as the Government National Mortgage Association (“GNMA” or “Ginnie Mae”), or a U.S. Government-sponsored entity (“GSE”), such as the Federal National Mortgage Association (“FNMA” or “Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“FHLMC” or “Freddie Mac”). The Agency RMBS we acquire can be secured by fixed-rate mortgages, adjustable-rate mortgages, or hybrid adjustable-rate mortgages. Fixed-rate mortgages have interest rates that are fixed for the term of the loan and do not adjust. The interest rates on adjustable-rate mortgages generally adjust annually (although some may adjust more frequently) to an increment over a specified interest rate index. Hybrid adjustable-rate mortgages have interest rates that are fixed for a specified period of time (typically three, five, seven or ten years) and, thereafter, adjust to an increment over a specified interest rate index. Adjustable-rate mortgages and hybrid adjustable-rate mortgages generally have periodic and lifetime constraints on the amount by which the loan interest rate can change on any predetermined interest rate reset date. These investments can be in the form of pools, TBA, and CMO (including interest only, principal only or other structures).

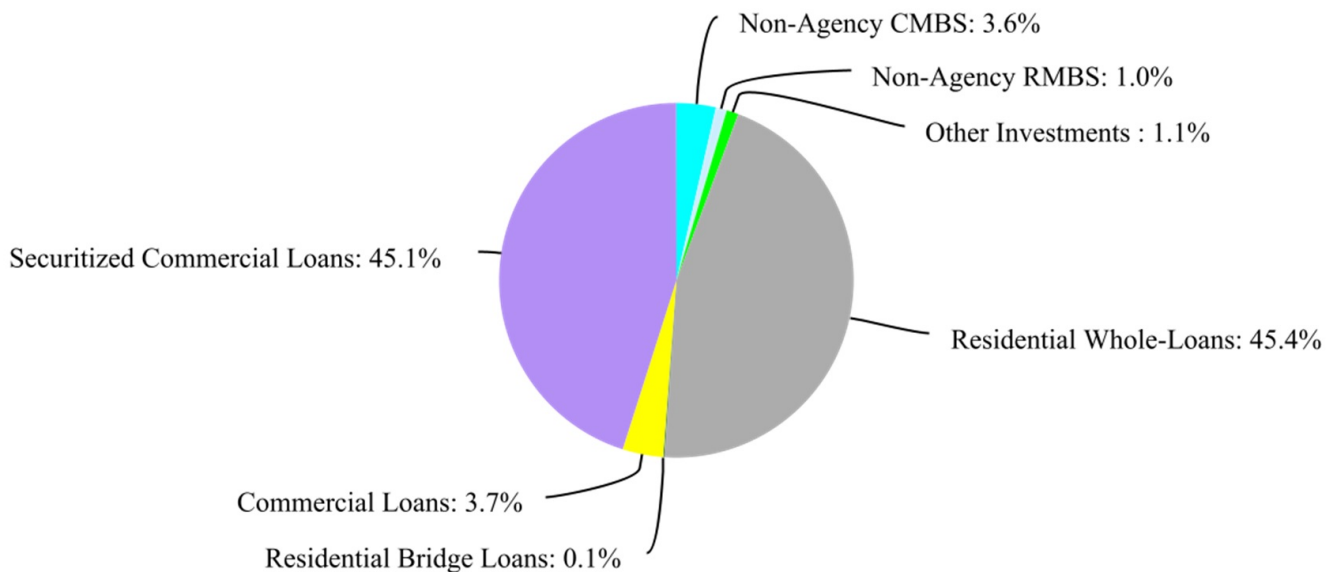
GSE Risk Sharing Securities Issued by Fannie Mae and Freddie Mac — From time to time we have and may in the future continue to invest in risk sharing securities issued by Fannie Mae and Freddie Mac. Principal and interest payments on these securities are based on the performance of a specified pool of Agency residential mortgages. The payments due on these securities, however, are not secured by the referenced mortgages. The payments due are full faith and credit obligations of Fannie Mae or Freddie Mac respectively, but neither agency guarantees full payment of the underlying mortgages. Investments in these securities generally are not qualifying assets for purposes of the 75% real estate asset test applicable to REITs and generally do not generate qualifying income for purposes of the 75% real estate income test applicable to REITs. As a result, we may be limited in our ability to invest in such assets.

Other investments — In addition to Residential Whole Loans and Non-Agency RMBS, our current target investments, we may also make investments in Commercial Loans and Non-Agency CMBS and other securities on an opportunistic basis, which our Manager believes will assist us in meeting our investment objective and are consistent with our overall investment policies. These investments will normally be limited by the REIT requirements that 75% our assets be real estate assets and that 75% of our income be generated from real estate, thereby limiting our ability to invest in such assets.

Our Investment Portfolio

Our investment strategy will focus on residential real estate related investments, including but not limited to non-qualified mortgage loans, Non-Agency RMBS, and other related investments. We are continuing to transition out of our commercial loan investments.

Our investment portfolio composition at December 31, 2022:



Our Financing Strategy

During 2020, the uncertainties created by the COVID-19 pandemic made it challenging to obtain financing arrangements on favorable terms. In the latter part of 2020 and the beginning of 2021, terms for financing arrangements began to improve significantly. As a result, we diversified our financing sources to provide an alternative to short-term repurchase agreements with daily margin requirements. We expect to continue to seek financing arrangements without daily margin requirements or with margin requirements that apply only after a significant reduction in the valuation of the assets financed, including but not limited to repurchase agreements, term financing, securitization and convertible senior unsecured notes, as the market permits. We believe the amount of leverage we use is consistent with our intention of keeping total borrowings within a prudent range, as determined by our Manager, taking into account a variety of factors such as general economic, political and financial market conditions, the anticipated liquidity and price volatility of our assets, the availability and cost of financing the assets, the creditworthiness of financing counterparties and the health of the U.S. residential and commercial mortgage markets. We expect to maintain a debt-to-equity ratio of two to four and a half times the amount of our stockholders' equity, depending on our investment composition. We seek to enhance equity returns by effectively utilizing leverage and seeking to limit our exposure to interest rate volatility and daily margin calls. The following table presents our debt-to-equity ratio on December 31, 2022 and December 31, 2021 (dollars in thousands):

	<u>December 31, 2022</u>	<u>December 31, 2021</u>
Total debt ⁽¹⁾	\$ 276,639	\$ 736,357
Total equity	\$ 94,804	\$ 193,109
Debt-to-equity ratio	<u>2.9</u>	<u>3.8</u>

(1) Total debt excludes the securitized debt which is non-recourse to us.

Our Hedging and Risk Management Strategy

Our overall portfolio strategy is designed to generate attractive returns to our investors through various economic cycles. In connection with our risk management activities, we may enter into a variety of derivative and non-derivative instruments. When purchased, our primary objective for acquiring these derivatives and non-derivative instruments is to mitigate our exposure to future events that are outside our control. Our derivative instruments are designed to mitigate the effects of market risk and cash flow volatility associated with interest rate risk, including prepayment risk. As part of our hedging strategy, we may enter into interest rate swaps, including forward starting swaps, interest rate swaptions, U.S. Treasury options, future contracts, TBAs, credit default swaps, forwards, and other similar instruments. There can be no assurance that appropriate hedging strategies will be available or that if implemented they will be successful.

Regulation

REIT Qualification

We elected to be taxed as a REIT under Section 856 through 860 of the Internal Revenue Code of 1986, as amended (the "Code"), commencing with our taxable year ended December 31, 2012. We will generally not be subject to corporate U.S. federal income tax to the extent that we make qualifying distributions to stockholders, and provided that we satisfy, on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. If we fail to qualify as a REIT, and do not qualify for certain statutory relief provisions, we 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 we lost our REIT qualification. The failure to qualify as a REIT could have a material adverse impact on our results of operations and amounts available for distribution to stockholders.

Investment Company Act Exemption

We conduct our operations so that we are not considered an investment company under the 1940 Act in reliance on the exemption provided by Section 3(c)(5)(C) of the 1940 Act. Section 3(c)(5)(C), as interpreted by the staff of the SEC, requires that: (i) at least 55% of our investment portfolio consist of "mortgages and other liens on and interest in real estate," or "qualifying real estate interests," and (ii) at least 80% of our investment portfolio consist of qualifying real estate interests plus "real estate-related assets." We have relied and intend to continue to rely on current interpretations of the staff of the SEC in an effort to continue to qualify for an exemption from registration under the 1940 Act. For more information on the exemptions that we utilize refer to Item 1A, "Risk Factors" of this Annual Report on Form 10-K.

Competition

Our net income depends, in part, on our ability to acquire assets at favorable spreads over our borrowing costs. In acquiring our target assets, we compete with other REITs, specialty finance companies, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, financial institutions, governmental bodies and other entities. In addition, other REITs with similar asset acquisition objectives, including others that may be organized in the future, compete with us in acquiring assets and obtaining financing. These competitors may be significantly larger than us, may have access to greater capital and other resources or may have other advantages. In addition, some competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments, and establish more relationships, than us. Current market conditions may attract more competitors, which may increase the competition for sources of financing. An increase in the competition for sources of funding could adversely affect the availability and cost of financing, and thereby adversely affect the market price of our common stock.

Environmental Matters

We are not aware of any federal, state or local environmental laws or regulations that will materially affect our earnings or statement of position or result in material capital expenditures.

Employees and Human Capital

The Company's Chief Financial Officer is our only employee. We are externally managed pursuant to the management agreement between us and the Manager dated May 9, 2012. Our remaining officers and two of our directors, James W. Hirschmann III and Bonnie M. Wongtrakool, are employees of our Manager. We benefit from our Manager's global infrastructure and operating platform, through which we are able to source, evaluate and manage potential investments in our target assets. Our Manager strives to create a diverse and inclusive workforce in operating its business. By supporting, recognizing, and investing in the employees, our Manager believes that it is able to attract and retain the highest quality talent.

Corporate Governance and Internet Address

We emphasize the importance of professional business conduct and ethics through our corporate governance initiatives. The Board has appointed a lead independent director to enhance governance. Currently, four of six directors are independent directors, so our Board of Directors consists of two-thirds independent directors. The audit, nominating and corporate governance, risk, and compensation committees of our Board of Directors are composed entirely of independent directors. We have adopted corporate governance guidelines and a code of business conduct and ethics, which delineate our standards for our officers and directors.

Our internet address is www.westernassetmcc.com. The information on our website is not incorporated by reference in this Annual Report on Form 10-K. We make available, free of charge through a link on our site, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to such reports, if any, as filed or furnished with the SEC, as soon as reasonably practicable after such filing or furnishing. Our site also contains our code of business conduct and ethics, corporate governance guidelines and the charters of our audit committee, nominating and corporate governance committee and compensation committee of our Board of Directors. Within the time period required by the rules of the SEC and the New York Stock Exchange, or NYSE, we will post on our website any amendment to our code of business conduct and ethics as defined in the code. Our documents filed with, or furnished to, the SEC are also available for review on the SEC's website at www.sec.gov.

ITEM 1A. RISK FACTORS

Our business and operations are subject to a number of risks and uncertainties, the occurrence of which could adversely affect our business, financial condition, results of operations and ability to make distributions to stockholders and could cause the value of our capital stock to decline.

RISK FACTOR SUMMARY

Risks related to our business

- We may not be able to make or sustain distributions to our stockholders.
- Increases in interest rates could adversely affect the value of our investments and cause our interest expense to increase.
- Changes to, and the replacement of LIBOR, may adversely affect interest expense related to our loans and interest income with respect to our investments.

Risks related to our investing strategy

- Our investments in Non-Agency MBS, Residential Whole Loans, and Commercial Loans involve credit risks, which could materially adversely affect our results of operations.
- A lack of liquidity in our investments may adversely affect our business.
- Our investments in Residential Whole Loans and Commercial Loans subject us to servicing-related risks, including those associated with foreclosure and liquidation.
- The commercial mortgage loans underlying the CMBS and our Commercial Loans we may acquire are subject to risks, which could result in losses to us.
- If our Manager overestimates the loss-adjusted yields of our CMBS investments, we may experience losses.
- If we do not control the special servicing of the mortgage loans included in the CMBS in which we invest and, in such cases, the special servicer may take actions that could adversely affect our interests.
- Our investments are recorded at fair value, and quoted prices, or observable inputs may not be available to determine such value, resulting in the use of significant unobservable inputs to determine value.
- We may be adversely effected by declines in value of the assets in which we invest.
- Interest rate mismatches between our RMBS and Whole Loans backed by ARMs or hybrid ARMs and our borrowings used to fund our purchases of these assets may cause us to suffer losses.
- Prepayment may adversely affect our profitability.

- Geographic concentration of the properties securing the mortgage loans underlying our investments exposes us to risk.
- We may make investments in non-U.S. dollar denominated securities, which will be subject to currency rate exposure and risks associated with the uncertainty of foreign laws and markets.

Risks related to financing and hedging

- We may be unable to access funding on advantageous terms, if at all.
- Our strategy to address interest rate risk may not be effective and could result in future realized losses.
- Our strategy involves significant leverage, which may amplify losses.
- Our Manager may not be able to prevent mismatches in the maturities of our assets and liabilities.
- We may be subject to margin calls under our master repurchase agreements.
- We may lose money on our repurchase transactions.
- If a counterparty to one of our swap agreements or TBAs defaults on its obligations, we may incur losses.
- We may fail to procure adequate repurchase agreement financing or to renew or replace repurchase agreement financing.
- Our repurchase agreement financing may require additional collateral or restrict us from leveraging our assets.
- An increase in our borrowing costs relative to the interest that we receive on our portfolio investments may adversely affect our profitability and cash available for distribution to our stockholders.
- Our inability to finance, refinance and securitize our investments in Residential and Commercial Whole Loans could materially and adversely affect our liquidity and earnings and limit the cash available for distribution to our stockholders.

Risks associated with our relationship with our Manager

- Our Manager has been granted broad investment authority.
- There are conflicts of interest in our relationship with our Manager and the Management Agreement with our Manager was not negotiated on an arm's-length basis and may be costly and difficult to terminate.
- We are dependent on our Manager and its key personnel for our success.
- Our Manager's management fee is payable regardless of our performance.

Risks related to our common stock

- We may pay taxable dividends in our common stock and cash, in which case stockholders may sell shares of our common stock to pay tax on such dividends, placing downward pressure on the market price of our common stock.
- The market price and trading volume of our common stock may vary substantially.
- Common stock eligible for future sale may have adverse effects on our share price.
- We have no minimum distribution payment level and cannot assure you of our ability to pay distributions in the future.
- Conversion of our convertible senior unsecured notes may dilute the ownership interest of existing stockholders.

Risks related to our organization and structure

- Ownership limitations may restrict change of control or business combination opportunities in which our stockholders might receive a premium for their shares.
- Provisions in our organizational documents and Delaware law may prevent or hinder a change in control and adversely affecting the market price of our common stock.

Risks related to REIT status

- We may fail to remain qualified as a REIT, incurring substantial tax liability.
- Dividends payable by REITs do not qualify for the reduced tax rates available for some dividends.
- REIT distribution requirements could adversely affect our ability to execute our business plan.
- Complying with REIT requirements may cause us to liquidate or forgo otherwise attractive opportunities.
- Our reported taxable income for certain investments may exceed the economic income we ultimately realize.
- Certain apportionment rules may affect our ability to comply with the REIT asset and gross income tests.
- The "taxable mortgage pool" rules may increase the taxes that we or our stockholders may incur, and may limit the manner in which we effect future securitizations.
- Our ability to invest in and dispose of "to be announced" securities could be limited by our REIT status.
- Securities subject to our repurchase agreements may not qualify as real estate assets, adversely affecting our REIT status.
- Liquidation of assets may jeopardize our REIT qualification or create additional tax liability for us.
- Complying with REIT requirements may limit our ability to hedge effectively and may cause us to incur tax liabilities.
- Qualifying as a REIT involves highly technical and complex provisions of the Code.

Risks related to our business

We may not be able to successfully operate our business or generate sufficient revenue to make or sustain distributions to our stockholders.

We cannot assure you that we will be able to continue to operate our business successfully or implement our operating policies and strategies as described herein. The results of our operations depend on several factors, including the availability of opportunities for the acquisition of assets, the level and volatility of interest rates, the availability of adequate short and long-term financing, conditions in the financial markets and economic conditions.

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

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

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

Our investment portfolio contains a significant allocation to MBS, as well Residential and Commercial Whole Loans. The relationship between short-term and longer-term interest rates is often referred to as the “yield curve.” In a normal yield curve environment, an investment in such assets will generally decline in value if long-term interest rates increase. Declines in market value may ultimately reduce earnings or result in losses to us, which may negatively affect cash available for distribution to our stockholders. Ordinarily, short-term interest rates are lower than longer-term interest rates. If short-term interest rates rise disproportionately relative to longer-term interest rates (a flattening of the yield curve), our borrowing costs will generally increase more rapidly than the interest income earned on our assets. Because our investments on average, generally bear interest based on longer-term rates than our borrowings, a flattening of the yield curve would tend to decrease our net interest margin, net income, book value and the market value of our net assets. It is also possible that short-term interest rates may exceed longer-term interest rates (a yield curve inversion), in which event our borrowing costs may exceed our interest income and we could incur operating losses. Additionally, to the extent cash flows from investments that return scheduled and unscheduled principal are reinvested, the spread between the yields on the new investments and available borrowing rates may decline, which would likely decrease our net income. A significant risk associated with our target assets is the risk that both long-term and short-term interest rates will increase significantly. If long-term rates increase significantly, the market value of these investments will decline, and the duration and weighted average life of the investments will increase. At the same time, an increase in short-term interest rates will increase the amount of interest owed on the repurchase agreements we enter into to finance the purchase of our investments.

Changes to, and the replacement of LIBOR may adversely affect interest expense related to our loans and investments.

In 2020, the FASB issued ASU 2020-04, which provides optional guidance for a limited period of time to ease the potential burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting. At the time that ASU 2020-04 was issued, the UK Financial Conduct Authority (“FCA”) had established its intent that it would no longer be necessary to persuade, or compel, banks to submit to LIBOR after December 31, 2021. As a result, a sunset provision for the optional guidance in Topic 848 was originally set for December 31, 2022, one year after the expected cessation date of all currencies and tenors of LIBOR.

In March 2021, the FCA announced that the intended cessation date of the overnight 1-, 3-, 6-, and 12-month tenors of USD LIBOR would be June 30, 2023, which was beyond the current sunset date of Topic 848. Accordingly, during December 2022, the FASB issued ASU 2022-06 to defer the sunset date of ASC Topic 848, Reference Rate Reform, which provides temporary optional relief in accounting for the impact of reference rate reform from December 31, 2022, to December 31, 2024, after which entities will no longer be permitted to apply the relief in Topic 848. The amendments apply to all entities that have contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform.

As such, with additional time granted to apply the relief in Topic 848 extended through December 31, 2024, Management will monitor legacy LIBOR reference rate contracts outstanding as of December 31, 2022 in the investment portfolio, as either they will terminate prior to the June 30, 2023 LIBOR cessation date currently set by the FCA, or the Company will use the practical expedients per Topic 848 to account for modifications to contracts prospectively within the scope of Topics 310, Receivables, and 470, Debt, as a continuation of the existing contracts, as long as no modifications effecting maturity or other terms are modified. The Company will adjust the effective interest rate of all contracts, hedging relationships, and other transactions that reference LIBOR to revised reference rates and spreads as they occur. The variable- and floating-rate note sectors have primarily transitioned away from LIBOR as the market has already adapted to the secured overnight financing rate (SOFR), as the primary index used by issuers.

We cannot assure you that our internal controls over financial reporting will consistently be effective.

We are responsible for establishing and maintaining adequate internal control over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. We cannot ensure you that there will not be any material weaknesses or significant deficiencies in our internal control over financial reporting in the future.

Cybersecurity risk and cyber incidents may adversely affect our business by causing a disruption to our operations, a compromise or corruption of our confidential information and/or damage to our business relationships, all of which could negatively impact our financial results.

A cyber incident is considered to be any adverse event that threatens the confidentiality, integrity or availability of our information resources. These incidents may be an intentional attack or an unintentional event and could involve gaining unauthorized access to our information systems for purposes of misappropriating assets, stealing confidential information, corrupting data or causing operational disruption. The result of these incidents may include disrupted operations, misstated or unreliable financial data, liability for stolen assets or information, increased cybersecurity protection and insurance cost, litigation and damage to our investor relationships. As our reliance on technology has increased, so have the risks posed to both our information systems, both internal and those provided by our Manager and third party service providers. Our Manager has implemented processes, procedures and internal controls to help mitigate cybersecurity risks and cyber intrusions, but these measures, as well as our increased awareness of the nature and extent of a risk of a cyber incident, do not guarantee that our financial results, operations or confidential information will not be negatively impacted by such an incident.

Risks related to our investing strategy

Our investments in Non-Agency MBS, Residential Whole Loans, and Commercial Loans involve credit risks, which could materially adversely affect our results of operations.

The holder of residential mortgages, commercial mortgages, or MBS assumes the risk that the related borrowers may default on their obligations to make full and timely payments of principal and interest. Under our investment policy, we have the ability to acquire Non-Agency MBS, Residential Whole Loans, and Commercial Loans. In general, these investments carry greater investment risk than Agency MBS, because the former are not guaranteed principal or interest by the U.S. Government, any federal agency, or any federally chartered corporation. Higher-than-expected rates of default and/or higher-than-expected loss severities on these investments could adversely affect the value of these assets. Accordingly, defaults in the payment of principal and/or interest on our Residential Whole Loans, Commercial Loans, and Non-Agency MBS would likely result in losses of income from, and/or losses in market value relating to these assets, which could materially adversely affect our results of operations.

In the last few years, our portfolio of Residential Whole Loans and Commercial Loans has increased, and we expect that our investment portfolio in residential real estate related investments will continue to increase during 2023. As a holder of these loans, we are subject to the risk that the related borrowers may default or have defaulted on their obligations to make full and timely payments of principal and interest. A number of factors impact a borrower's ability to repay including, among other things, changes in employment status, changes in interest rates or the availability of credit, and changes in real estate values. In addition to the credit risk associated with these assets, Residential Whole Loans and Commercial Loans are less liquid than certain of our other credit sensitive assets, which may make them more difficult to dispose of if the need or desire arises. If actual results are different from our assumptions in determining the prices paid to acquire such loans, particularly if the market value of the underlying properties decreases significantly subsequent to purchase, we may incur significant losses, which could materially adversely affect our results of operations.

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

We operate in a highly competitive market for investment opportunities. Currently, our profitability depends, in large part, on our ability to acquire our portfolio assets at attractive prices. In acquiring these assets, we compete with a variety of institutional investors, including other REITs, specialty finance companies, public and private funds (including other funds managed by our Manager), commercial and investment banks, commercial finance and insurance companies, and other financial institutions. Many of our competitors are substantially larger and have considerably greater financial, technical, and marketing resources than we do. Other REITs have recently raised, or may raise, additional capital, and may have investment objectives that overlap with ours, which may create additional competition for investment opportunities. Some competitors may have a lower cost of funds and access to funding sources that may not be available to us, such as funding from the U.S. Government. Many of our competitors are not subject to the operating constraints associated with REIT tax compliance or maintenance of an exemption from the 1940 Act. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, competition for investments in our portfolio assets may lead to the price of such assets increasing, which may further limit our ability to generate desired returns. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition, and results of operations. Also, as a result of this competition, desirable investments in these assets may be limited in the future and we may not be able to take advantage of attractive investment opportunities from time to time, as we can provide no assurance that we will be able to identify and make investments that are consistent with our investment objectives.

A lack of liquidity in our investments may adversely affect our business.

Many of the assets we acquire are not publicly traded. A lack of liquidity may result from the absence of a willing buyer or an established market for these assets, as well as legal or contractual restrictions on resale or the unavailability of financing for these assets. In addition, mortgage-related assets generally experience periods of illiquidity, especially during periods of economic stress such as the economic recession in 2008 or the shock caused by the sudden global impact of the COVID-19 pandemic, which resulted in increased delinquencies and defaults with respect to residential and commercial mortgage loans. The illiquidity of our investments may make it difficult for us to sell such investments if the need or desire arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded our investments. Further, we may face other restrictions on our ability to liquidate an investment in a business entity to the extent that we or our Manager has or could be attributed with material, non-public information regarding such business entity. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited, which could adversely affect our results of operations and financial condition.

An economic recession and declining real estate values could impair our assets and harm our operations.

The risks associated with our business are more severe during economic recessions and are compounded by declining real estate values. The Residential Whole Loans, Commercial Loans, Non-Agency RMBS and Non-Agency CMBS in which we invest a part of our capital will be particularly sensitive to these risks. Declining real estate values will likely reduce the level of new mortgage loan originations since borrowers often use appreciation in the value of their existing properties to support the purchase of additional properties. Borrowers will also be less able to pay principal and interest on loans underlying the securities in which we invest if the value of residential and commercial real estate weakens further. Further, declining real estate values significantly increase the likelihood that we will incur losses on these investments in the event of default because the value of collateral on the mortgages underlying such securities may be insufficient to cover the outstanding principal amount of the loan. Any sustained period of increased payment delinquencies, foreclosures or losses could adversely affect our net interest income from these investments, which could have an adverse effect on our financial condition, results of operations and our ability to make distributions to our stockholders

Our investments in Residential Whole Loans, and Commercial Loans subject us to servicing-related risks, including those associated with foreclosure and liquidation.

We rely on third-party servicers to service and manage the mortgages underlying our loan portfolio. The ultimate returns generated by these investments may depend on the quality of the servicer. If a servicer is not vigilant in seeing that borrowers make their required monthly payments, borrowers may be less likely to make these payments, resulting in a higher frequency of default. If a servicer takes longer to liquidate non-performing mortgages, our losses related to those loans may be higher than originally anticipated. Any failure by servicers to service these mortgages and/or to competently manage and dispose of REO properties could negatively impact the value of these investments and our financial performance. In addition, while we have contracted with third-party servicers to carry out the actual servicing of the loans (including all direct interface with the borrowers), for loans that we purchase together with the related servicing rights, we are nevertheless ultimately responsible, vis-à-vis the borrowers and state and federal regulators, for ensuring that the loans are serviced in accordance with the terms of the related notes and mortgages and applicable law and regulation. In light of the current regulatory environment, such exposure could be significant even though we might have contractual claims against our servicers for any failure to service the loans to the required standard.

The foreclosure process, especially in judicial foreclosure states such as New York, Florida, and New Jersey, can be lengthy and expensive, and the delays and costs involved in completing a foreclosure, and then subsequently liquidating the REO property through sale, may materially increase any related loss. In addition, at such time as title is taken to a foreclosed property, it may require more extensive rehabilitation than we estimated at acquisition. Thus, a material amount of foreclosed residential mortgage loans, particularly in the states mentioned above, could result in significant losses in our Residential Whole Loan portfolio and could materially adversely affect our results of operations.

The commercial mortgage loans underlying the CMBS and our Commercial Loans we may acquire are subject to defaults, foreclosure timeline extension, fraud and commercial price depreciation and unfavorable modification of loan principal amount, interest rate and amortization of principal, which could result in losses to us.

CMBS may be secured by a single commercial mortgage loan or a pool of commercial mortgage loans. Commercial mortgage loans may be secured by multifamily or commercial property and are subject to risks of delinquency and foreclosure, and risks of loss that may be greater than similar risks associated with loans made on the security of residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced, the borrower's ability or willingness to repay the loan may be impaired. Net operating income of an income-producing property can be affected by, among other things:

- tenant mix;
- success of tenant businesses;
- property management decisions;
- property location and condition;
- competition from comparable types of properties;

- changes in laws that increase operating expenses or limit rents that may be charged;
- any need to address environmental contamination at the property or the occurrence of any uninsured casualty at the property;
- changes in national, regional or local economic conditions and/or specific industry segments;
- declines in regional or local real estate values;
- declines in regional or local rental or occupancy rates;
- increases in interest rates;
- real estate tax rates and other operating expenses;
- changes in governmental rules, regulations and fiscal policies, including environmental legislation; and
- acts of God, terrorist attacks, social unrest and civil disturbances.

If our Manager overestimates the loss-adjusted yields of our CMBS investments, we may experience losses.

Our Manager will analyze any CMBS investments we may acquire based on loss-adjusted yields, taking into account estimated future losses on the mortgage loans included in the securitization's pool of loans, and the estimated impact of these losses on expected future cash flows. Our Manager's loss estimates may not prove accurate, as actual results may vary from estimates. In the event that our Manager underestimates the pool level losses relative to the price we pay for a particular CMBS investment, we may experience losses with respect to such investment.

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

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

Our investments are recorded at fair value, and quoted prices, or observable inputs may not be available to determine such value, resulting in the use of significant unobservable inputs to determine value.

We expect that the values of some of our investments may not be readily determinable. We measure the fair value of these investments on at least a monthly basis. The fair value at which our assets are recorded may not be an indication of their realizable value. Ultimate realization of the value of an asset depends to a great extent on economic and other conditions that are beyond the control of our Manager, our Company, or our Board of Directors. Further, fair value is only an estimate based on good faith judgment of the price at which an investment can be sold since market prices of investments can only be determined by negotiation between a willing buyer and seller. If we were to liquidate a particular asset, the realized value may be more than or less than the amount at which such asset is valued. Accordingly, the value of our common stock could be adversely affected by our determinations regarding the fair value of our investments, whether in the applicable period or in the future. Additionally, such valuations may fluctuate over short periods of time.

Our determination of the fair value of our investments for GAAP includes inputs provided by third party dealers and pricing services. Valuations of certain investments in which we invest are often difficult to obtain. In general, dealers and pricing services heavily disclaim their valuations. Dealers may claim to furnish valuations only as an accommodation and without special compensation, and so they may disclaim any and all liability for any direct, incidental, or consequential damages arising out of any inaccuracy or incompleteness in valuations, including any act of negligence or breach of any warranty. Depending on the complexity and illiquidity of a security, valuations of the same security can vary substantially from one dealer or pricing service to another. Therefore, our results of operations for a given period could be adversely affected if our determinations regarding the fair market value of these investments are materially different than the values that we ultimately realize upon their disposal. Due to an overall increase in market volatility, the valuation process has been particularly challenging recently as market events have made valuations of certain assets more difficult, unpredictable and volatile.

Declines in value of the assets in which we invest will adversely affect our financial position and results of operations, and make it more costly to finance these assets.

We use our investments as collateral for our financings. Any decline in their value, or perceived market uncertainty about their value, would likely make it difficult for us to obtain financing on favorable terms or at all, or maintain our compliance with terms of any financing arrangements already in place. Our investments in mortgage-backed securities and Whole Loans are recorded at fair value under a fair value option election at the time of purchase with changes in fair value reported in earnings. As a result, a decline in fair values of our mortgage-backed securities and Whole Loans could reduce both our earnings and stockholders' equity. If market conditions result in a decline in the fair value of our assets, our financial position and results of operations could be adversely affected.

Interest rate mismatches may occur between our RMBS and Whole Loans backed by ARMs and hybrid ARMs, in relation to the debt used to fund the acquisition of these assets, which may cause us to suffer losses.

We may fund our RMBS and Whole Loans with borrowings that have interest rates that adjust more frequently than the interest rate indices and repricing terms of RMBS and Whole Loans backed by adjustable-rate mortgages, or ARMs, or hybrid ARMs. Accordingly, if short-term interest rates increase, our borrowing costs may increase faster than the interest rates on RMBS and Whole Loans backed by ARMs or hybrid ARMs adjust. As a result, in a period of rising interest rates, we could experience a decrease in net income or a net loss.

In addition, RMBS and Whole Loans backed by ARMs or hybrid ARMs will typically be subject to lifetime interest rate caps that limit the amount an interest rate can increase through the maturity of the RMBS and Whole Loans. However, our borrowings under repurchase agreements typically are not subject to similar restrictions. Accordingly, in a period of rapidly increasing interest rates, the interest rates paid on our borrowings could increase without limitation, while caps could limit the interest rates on these types of RMBS and Whole Loans. This problem is magnified for RMBS and Whole Loans backed by ARMs or hybrid ARMs that are not fully indexed. Further, some RMBS and Whole Loans backed by ARMs or hybrid ARMs may be subject to periodic payment caps that result in a portion of the interest being deferred and added to the principal outstanding. As a result, we may receive less cash income on these types of RMBS and Whole Loans than we need to pay interest on our related borrowings. These factors could reduce our net interest income and cause us to suffer a loss during periods of rising interest rates.

Prepayment may adversely affect our profitability.

The RMBS assets and Residential Whole Loans we acquire are backed by pools of residential mortgage loans. We receive payments, generally, from the payments that are made on these underlying residential mortgage loans. While commercial mortgages frequently include limitations on the ability of the borrower to prepay, residential mortgages generally do not. When borrowers prepay their residential mortgage loans at rates that are faster than expected, this may adversely affect our profitability.

We may purchase RMBS assets and Residential Whole Loans that have higher interest rates than the then prevailing market interest rates, and in exchange for this higher interest rate, we may pay a premium to par value to acquire the asset. In accordance with accounting rules, we amortize this premium over the expected term of the asset. If the asset is prepaid in whole or in part at a faster than expected rate, we must expense all or a part of the remaining unamortized portion of the premium, which can adversely affect our profitability.

Prepayments generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment are difficult to predict. House price appreciation, while increasing the value of the collateral underlying our RMBS and Residential Whole Loans, may increase prepayments as borrowers may be able to refinance at more favorable terms. Prepayments can also occur when borrowers default on their residential mortgages and the mortgages are prepaid from the proceeds of a foreclosure sale of the property (an involuntary prepayment), or when borrowers sell the property and use the sale proceeds to prepay the mortgage as part of a physical relocation. Prepayments also may be affected by conditions in the housing and financial markets, increasing defaults on residential mortgage loans, which could lead to an acceleration of the payment of the related principal, general economic conditions and the relative interest rates on fixed-rate mortgages and ARMs. While we seek to manage prepayment risk, in selecting RMBS and Residential Whole Loans investments we must balance prepayment risk against other risks, the potential returns of each investment and the cost of hedging our risks. No strategy can completely insulate us from prepayment or other such risks, and we may deliberately retain exposure to prepayment or other risks.

In addition, a decrease in prepayments may adversely affect our profitability. When borrowers prepay their residential mortgage loans at slower than expected rates, prepayments on the RMBS may be slower than expected. These slower than expected payments may adversely affect our profitability. We may purchase RMBS assets that have a lower interest rate than the then prevailing market interest rate. In exchange for this lower interest rate, we may pay a discount to par value to acquire the asset. In accordance with accounting rules, we accrete this discount over the expected term of the asset based on our prepayment assumptions. If the asset is prepaid at a slower than expected rate, however, we must accrete the remaining portion of the discount at a slower than expected rate. This will extend the expected life of the asset and result in a lower than expected yield on assets purchased at a discount to par.

We could be materially and adversely affected by poor market conditions where the properties securing the mortgage loans underlying our investments are geographically concentrated.

Our performance depends on the economic conditions in markets in which the properties securing the mortgage loans underlying our investments are concentrated. As of December 31, 2022, a substantial portion of our investments had underlying properties in California. Our financial condition, results of operations, the market price of our common stock, and our ability to make distributions to our stockholders could be materially and adversely affected by this geographic concentration if market conditions, such as an oversupply of space, or a reduction in demand for real estate in an area, deteriorate in California. Moreover, due to the geographic concentration of properties securing the mortgages underlying our investments, the Company may be disproportionately affected by general risks such as natural disasters, including major wildfires, floods, earthquakes, and severe or inclement weather, should such developments occur in or near the markets in California in which such properties are located.

We may incur losses as a result of unforeseen or catastrophic events, including the emergence of a pandemic and acts of terrorism.

The occurrence of unforeseen or catastrophic events, including the emergence of a pandemic, such as COVID-19 and its variants, or other widespread health emergency (or concerns over the possibility of such an emergency), and terrorist attacks could create economic and financial disruptions, which could lead to operational difficulties that could impair our ability to manage our businesses.

We may make investments in non U.S. dollar denominated securities, which will be subject to currency rate exposure and risks associated with the uncertainty of foreign laws and markets.

Some of our real estate-related securities investments may be denominated in foreign currencies, and, therefore, we expect to have currency risk exposure to any such foreign currencies. A change in foreign currency exchange rates may have an adverse impact on returns on our non U.S. dollar denominated investments. Although we may hedge our foreign currency risk subject to the REIT income tests, we may not be able to do so successfully and may incur losses on these investments as a result of exchange rate fluctuations. To the extent that we invest in non U.S. dollar denominated securities, in addition to risks inherent in the investment in securities generally discussed in this Annual Report on Form 10-K, we will also be subject to risks associated with the uncertainty of foreign laws and markets, including, but not limited to, unexpected changes in regulatory requirements, political and economic instability in certain geographic locations, difficulties in managing international operations, currency exchange controls, potentially adverse tax consequences, additional accounting and control expenses, and the administrative burden of complying with a wide variety of foreign laws.

We are highly dependent on information systems and systems failures could significantly disrupt our business, which may, in turn, negatively affect the market price of our common stock and our ability to make distributions to all stockholders.

Our business is highly dependent on communications and information systems of our Manager and other third party service providers. Any failure or interruption of our Manager's or other third party service providers' systems could cause delays or other problems in our securities trading activities, which could have a material adverse effect on our operating results and negatively affect the market price of our common stock and our ability to make distributions to our stockholders.

Loss of our exemption from regulation pursuant to the 1940 Act would adversely affect us.

We conduct our business so as not to become regulated as an investment company under the 1940 Act in reliance on the exemption provided by Section 3(c)(5)(C) of the 1940 Act. Section 3(c)(5)(C), as interpreted by the staff of the SEC, requires that: (i) at least 55% of our investment portfolio consist of "mortgages and other liens on and interest in real estate," or "qualifying real estate interests," and (ii) at least 80% of our investment portfolio consist of qualifying real estate interests plus "real estate-related assets." In satisfying this 55% requirement, based on pronouncements of the SEC staff, we may treat whole pool Agency RMBS and CMBS as qualifying real estate interests. The SEC staff has not issued guidance with respect to whole pool Non-Agency RMBS. Accordingly, based on our own judgment and analysis of the SEC's pronouncements with respect to whole pool Agency RMBS, we may also treat Non-Agency RMBS issued with respect to an underlying pool of mortgage loans in which we hold all of the certificates issued by the pool as qualifying real estate interests. We currently treat partial pool Agency, Non-Agency RMBS and partial pool CMBS as real estate-related assets. We treat any ABS, interest rate swaps, or other derivative hedging transactions we enter into as miscellaneous assets that will not exceed 20% of our total assets. We rely on guidance published by the SEC staff or on our analyses of guidance published with respect to other types of assets to determine which assets are qualifying real estate assets and real estate-related assets.

The SEC in 2011 solicited public comment on a wide range of issues relating to Section 3(c)(5)(C), 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. There can be no assurance that the laws and regulations governing the 1940 Act status of REITs, including the guidance of the Division of Investment Management of the SEC regarding this exemption, will not change in a manner that adversely affects our operations. To the extent that the SEC or its staff publishes new or different guidance with respect to these matters, we may be required to adjust our strategy accordingly. In addition, we may be limited in our ability to make certain investments and these limitations could require us to hold assets we might wish to sell or to sell assets we might wish to hold. To the extent that the SEC staff provides more specific guidance regarding any of the matters bearing upon the exemption we rely on from the 1940 Act, 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.

The mortgage related investments that we acquire are limited by the provisions of the 1940 Act and the rules and regulations promulgated thereunder. If the SEC determines that any of these securities are not qualifying interests in real estate or real estate-related assets, adopts a contrary interpretation with respect to these securities or otherwise believes we do not satisfy the above exceptions or changes its interpretation of the above exceptions, we could be required to restructure our activities or sell certain of our assets. We may be required at times to adopt less efficient methods of financing certain of our mortgage related investments and we may be precluded from acquiring certain types of higher yielding securities. The net effect of these factors would be to lower our net interest income. If we fail to qualify for an exemption from registration as an investment company or an exclusion from the definition of an investment company, our ability to use leverage would be substantially reduced. Further, if the SEC determined that we were an unregistered investment company, we could be subject to monetary penalties and injunctive relief in an action brought by the SEC, we would potentially be unable to enforce contracts with third parties which could seek to obtain rescission of transactions undertaken during the period for which it was established we were an unregistered investment company. If we were required to register as an investment company, it would result in a change of our financial statement requirements. Our business will be materially and adversely affected if we fail to qualify for

this exemption from regulation pursuant to the 1940 Act. In addition, the loss of our 1940 Act exemption would also permit our Manager to terminate the Management Agreement, which could result in material adverse effect on our business and results of operations.

Compliance with our 1940 Act exemption will limit our ability to invest in certain of our target assets.

At times the Manager may be limited in allocating equity to target that do not qualify as real estate or real estate related assets for purposes of the 1940 Act exemption. This limitation could adversely affect the performance of our portfolio if these non qualifying assets presents more attractive investment opportunities. Among the current target assets that are not real estate assets are ABS, non-pool Agency and Non-Agency MBS, GSE Risk Sharing Securities, and certain Commercial Mezzanine Loans.

Risks related to financing and hedging

Our inability to access funding or the terms on which such funding is available could have a material adverse effect on our financial condition.

Our ability to fund our operations, meet financial obligations and finance our asset may be impacted by our ability to secure and maintain our financings and other borrowings with our counterparties. If we are not able to renew our existing facilities or arrange for new financing on terms acceptable to us, or if we default on our covenants or are otherwise unable to access funds under our financing facilities or if we are required to post collateral or face larger haircuts, we may have to dispose of assets at significantly depressed prices and at inopportune times, which could cause significant losses.

In addition, if the regulatory capital requirements imposed on our lenders change, they may be required to significantly increase the cost of the financing that they provide to us. Our lenders also have revised and may continue to revise their eligibility requirements for the types of assets they are willing to finance or the terms of such financings, including haircuts, and requiring additional collateral in the form of cash, based on, among other factors, the regulatory environment and their management of actual and perceived risk, particularly with respect to assignee liability. Moreover, the amount of financing we receive under our financing arrangements will be directly related to our lenders' valuation of our assets subject to such agreements. Typically, repurchase agreements grant the lender the absolute right to reevaluate the fair market value of the assets that cover outstanding borrowings at any time. If a lender determines in its sole discretion that the value of the assets has decreased, it has the right to initiate a margin call. These valuations may be different than the values that we ascribe to these assets and may be influenced by recent asset sales and distressed levels by forced sellers. A margin call requires us to transfer additional assets to a lender without any advance of funds from the lender for such transfer or to repay a portion of the outstanding borrowings.

If in the future we are unable to post adequate collateral for a margin call by a counterparty, in a time frame as short as the close of the same business day, it could result in a condition of default under certain of our repurchase agreements, thereby enabling the counterparty to liquidate the collateral pledged by us, which may have a material adverse effect on our financial position, results of operations, and cash flows.

Our strategy involves leverage, which may amplify losses.

Our current target leverage generally ranges between two to four and a half the amount of our stockholders' equity (calculated in accordance with U.S. GAAP). We incur this leverage by borrowing against a substantial portion of the market value of our assets. By utilizing this leverage, we can enhance our returns. Nevertheless, this leverage, which is fundamental to our investment strategy, also creates significant risks.

As a result of our significant leverage, we may incur substantial losses if our borrowing costs increase. Our borrowing costs may increase for any of the following reasons:

- short-term interest rates increase;
- the market value of our securities decreases;
- interest rate volatility increases; or
- the availability of financing in the market decreases.

Fluctuations in interest rates could materially affect our financial results

Interest rate fluctuations could reduce income generated by our assets and could increase our financing costs, which may adversely affect our earnings, and our cash available for distribution to our stockholders. Changes in interest rates may also affect borrowers' ability to pay and lead to increasing default rates in the portfolio. Changes in interest rates will have an affect on our operating results, as such changes will affect the interest we receive on any floating rate interest bearing assets and the financing cost of our floating rate debt, as well as our interest rate swaps utilized for hedging purposes. During 2022, global markets experienced a dramatic 425 bps increase in the FOMC's target federal funds rate from the start of the year, rising from 0.00% - 0.25% to 4.25% - 5.00%, as Central Banks around the world battle with global inflation rates not seen in decades, with some indicators showing inflation rates slowing their rate of increase at the close of the year. As such, this resulted in downward pressure on interest yielding valuations across all asset types and specific to the Company, resulted in significant unrealized fair value markdowns to its investment portfolio as of December 31, 2022.

There can be no assurance that our Manager will be able to prevent mismatches in the maturities of our assets and liabilities.

Because we employ financial leverage in funding our portfolio, mismatches in the maturities of our assets and liabilities can create risk in the need to continually renew or otherwise refinance our liabilities. Our net interest margins are dependent upon a positive spread between the returns on our asset portfolio and our overall cost of funding. Our Manager actively employs portfolio-wide and security-specific risk measurement and management processes in our daily operations. Our Manager's risk management tools include software and services licensed or purchased from third parties, in addition to proprietary systems and analytical methods developed internally. There can be no assurance that these tools and the other risk management techniques described above will protect us from asset/liability risks.

We may be subject to margin calls under our master repurchase agreements, which could result in defaults or force us to sell assets under adverse market conditions or through foreclosure.

We have entered into master repurchase agreements with various financial institutions and borrow under these master repurchase agreements to finance the acquisition of assets for our investment portfolio. Pursuant to the terms of borrowings under our master repurchase agreements, a decline in the value of the subject assets may result in our lenders initiating margin calls. A margin call means that the lender requires us to pledge additional collateral to re-establish the ratio of the value of the collateral to the amount of the borrowing. The specific collateral value to borrowing ratio that would trigger a margin call is not set in the master repurchase agreements and will not be determined until we engage in a repurchase transaction under these agreements. Our fixed-rate securities generally are more susceptible to margin calls as increases in interest rates tend to have a greater negative affect on the market value of fixed-rate securities. If we are unable to satisfy margin calls, our lenders may foreclose on our collateral. The threat of or occurrence of a margin call could force us to sell our assets, either directly or through a foreclosure, under adverse market conditions. Due to the significant leverage we carry, we may incur substantial losses upon the threat or occurrence of a margin call.

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

When we engage in repurchase transactions, we generally sell securities to lenders (repurchase agreement counterparties) and receive cash from these lenders. The lenders are obligated to resell the same securities back to us at the end of the term of the transaction, and since the cash we receive from the lender when we initially sell the securities to the lender will be less than the value of those securities (this difference is the haircut), if the lender defaults on its obligation to resell the same securities back to us we may incur a loss on the transaction equal to the amount of the haircut (assuming there was no change in the value of the securities). We would also lose money on a repurchase transaction if the value of the underlying securities has declined as of the end of the transaction term, as we would have to repurchase the securities based on their initial value but would receive securities worth less than that amount. Further, if we default on one of our obligations under a repurchase transaction, the lender can terminate the transaction and cease entering into any other repurchase transactions with us. Our inability to post adequate collateral for a margin call by the counterparty, in a time frame as short as the close of the same business day, could result in a condition of default under our repurchase agreements, thereby enabling the counterparty to liquidate the collateral pledged by us, which may have a material adverse effect on our financial position, results of operations, and cash flows. Certain of our repurchase agreements contain cross-default provisions, such that if a default occurs under an agreement with any specific lender, that lender could also declare a default under other repurchase agreements or other financing or derivative contracts, if any, with such lender. Further, three of the counterparties to our repurchase agreements held as of December 31, 2022, have collateral valued in excess of 5% of our stockholders' equity as security for our obligations under the applicable repurchase agreements. Any losses we incur on our repurchase transactions could adversely affect our earnings and thus our cash available for distribution to our stockholders.

If a counterparty to one of our swap agreements or TBAs defaults on its obligations, we may incur losses.

If a counterparty to one of the bilateral swap agreements or TBAs that we enter into defaults on its obligations under the agreement, we may not receive payments due under the agreement, and thus, we may lose any unrealized gain associated with the agreement. In the case of a swap agreement, the fact that such swap agreement hedged a liability means that the liability could cease to be hedged upon the default of a counterparty. Additionally, we may also risk the loss of any collateral we have pledged to secure our obligations under a bilateral swap agreement if the counterparty, or in the case of a cleared swap, if our clearing broker, becomes insolvent or files for bankruptcy.

Failure to procure adequate repurchase agreement financing, which generally have short terms, or to renew or replace repurchase agreement financing as it matures, would adversely affect our results of operations.

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

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

We cannot assure you that any, or sufficient repurchase agreement financing will be available to us on terms that are acceptable. In recent years, investors and financial institutions that lend in the securities repurchase market have tightened lending standards in response to the difficulties and changed economic conditions that have materially adversely affected the MBS market. These market disruptions have been most pronounced in the Non-Agency MBS market, and the impact has also extended to Agency MBS, which has made the value of these assets unstable and relatively illiquid compared to prior periods. Any decline in their value, or perceived market uncertainty about their value, would make it more difficult for us to obtain financing on favorable terms or at all, or maintain our compliance with terms of any financing arrangements then in place.

As of December 31, 2022, we had amounts outstanding under six repurchase agreements with three different counterparties. Prior to entering into a lending relationship with any financial institution, our Manager does a thorough credit review of such potential lender. Notwithstanding the foregoing, a material adverse development involving one or more major financial institutions or the financial markets in general, in addition to the regulatory changes, could result in our lenders reducing our access to funds available under our repurchase agreements or terminating such agreements altogether.

Furthermore, our ability to achieve our investment objectives will depend, not only on our ability to borrow money in sufficient amounts and on favorable terms, but also on our ability to renew or replace our financing arrangements. If we are unable to renew or replace our maturing borrowings due to liquidity shortfalls in the market and other funding markets, changes in the regulatory environment or for any other reason, we will have to sell some or all of our assets, possibly under adverse market conditions which may have a material adverse effect on our financial position, results of operations, and cash flows. In addition, the aforementioned changes to the regulatory capital requirements imposed on our lenders may significantly increase the cost of the financing that they provide to us. Our lenders also may revise their eligibility requirements for the types of assets they are willing to finance or the terms of such financings, based on, among other factors, the recent changes in the regulatory environment and their management of perceived risk, particularly with respect to assignee liability.

Our repurchase agreement financing may require us to provide additional collateral and may restrict us from leveraging our assets as fully as desired.

We use repurchase agreements to finance acquisitions of our investments. If the market value of the asset pledged or sold by us to a financing institution pursuant to a repurchase agreement declines, we may be required by the financing institution to provide additional collateral or pay down a portion of the funds advanced, but we may not have the funds available to do so, which could result in defaults. Posting additional collateral to support our credit will reduce our liquidity and limit our ability to leverage our assets, which could adversely affect our business. In the event we do not have sufficient liquidity to meet such requirements, financing institutions can accelerate repayment of our indebtedness, increase interest rates, liquidate our collateral or terminate our ability to borrow. Such a situation would likely result in a rapid deterioration of our financial condition and possibly necessitate a filing for bankruptcy protection.

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

Lenders may require us to enter into restrictive covenants relating to our operations.

When we obtain further financing, lenders could impose restrictions on us that would affect our ability to incur additional debt, our capability to make distributions to stockholders, and our flexibility to determine our operating policies. Loan documents we execute may contain negative covenants that limit, among other things, our ability to repurchase stock, distribute more than a certain amount of our funds from operations, and employ leverage beyond certain amounts.

Our rights under repurchase agreements may be subject to the effects of the bankruptcy laws in the event of the bankruptcy or insolvency of us or our counterparties under the repurchase agreements.

In the event of our insolvency or bankruptcy, certain repurchase agreements may qualify for special treatment under the U.S. Bankruptcy Code, the effect of which, among other things, would be to allow the lender under the applicable repurchase agreement to avoid the automatic stay provisions of the U.S. Bankruptcy Code and to take possession of and liquidate the assets that we have pledged under their repurchase agreements. In the event of the insolvency or bankruptcy of a lender during the term of a repurchase agreement, the lender may be permitted, under applicable insolvency laws, to repudiate the contract, and our claim against the lender for damages may be treated simply as the claim of an unsecured creditor. In addition, if the lender is a broker or dealer subject to the Securities Investor Protection Act of 1970, or an insured depository institution subject to the Federal Deposit Insurance Act, our ability to exercise our rights to recover our securities under a repurchase agreement or to be compensated for any damages resulting from the lender's insolvency may be further limited by those statutes. These claims would be subject to significant delay and, if and when received, may be substantially less than the damages we actually incur.

An increase in our borrowing costs relative to the interest that we receive on our portfolio investments may adversely affect our profitability and cash available for distribution to our stockholders.

As long as we earn a positive spread between interest and other income we earn on our leveraged assets and our borrowing costs, we believe that we can generally increase our profitability by using greater amounts of leverage. We cannot, however, assure you that repurchase financing will remain an efficient source of long-term financing for our assets. The amount of leverage that we use may be limited because our lenders might not make funding available to us or they may require that we provide additional collateral to secure our borrowings. If our financing strategy is not viable, we will have to find alternative forms of financing for our

assets which may not be available to us on acceptable terms or at acceptable rates. In addition, in response to certain interest rate and investment environments or to changes in the market liquidity, we could adopt a strategy of reducing our leverage by selling assets or not reinvesting principal payments as MBS amortize and/or prepay, thereby decreasing the outstanding amount of our related borrowings. Such an action could reduce interest income, interest expense and net income, the extent of which would be dependent on the level of reduction in assets and liabilities as well as the sale prices for which assets were sold.

As our financings mature, we will be required either to enter into new borrowings or to sell certain of our investments. Since we rely primarily on borrowings under repurchase agreements to finance our assets, our ability to achieve our investment objectives depends on our ability to borrow funds in sufficient amounts and on acceptable terms, and on our ability to renew or replace maturing borrowings on a continuous basis. Our repurchase agreement credit lines are renewable at the discretion of our lenders and, as such, do not contain guaranteed roll-over terms. Our ability to enter into repurchase transactions in the future will depend on the market value of our assets pledged to secure the specific borrowings, the availability of acceptable financing and market liquidity and other conditions existing in the lending market at that time. If we are unable to renew or replace maturing borrowings, we could be forced to sell assets in order to maintain liquidity. Forced sales under adverse market conditions could result in lower sales prices than ordinary market sales in the normal course of business. Further, an increase in short-term interest rates at the time that we seek to enter into new borrowings would reduce the spread between our returns on our assets and the cost of our borrowings. This would adversely affect our returns on our assets, which might reduce earnings and, in turn, cash available for distribution to our stockholders.

Our investments in Residential and Commercial Whole Loans are difficult to value and are dependent upon the ability to finance, refinance and securitize such investments. The inability to do so could materially and adversely affect our liquidity and earnings and limit the cash available for distribution to our stockholders.

We may seek to finance and refinance our Residential Whole Loans and Commercial Whole Loans to generate greater value from such loan. However, there may be impediments to executing either a financing or refinancing strategy for these investments. The financing of these investments presents additional challenges because in general it is less available than repurchase financing for MBS, especially Agency CMBS and Agency RMBS, and likely to have less advantageous pricing and more onerous terms. Accordingly, there can be no assurance that we will be able to finance Whole Loans at all, let alone on terms we believe are advantageous.

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

Subject to maintaining our qualification as a REIT and exemption from registration under the 1940 Act, part of our investment strategy may involve entering into economic hedging transactions that could require us to fund cash payments in certain circumstances (such as the early termination of the hedging instrument caused by an event of default or other early termination event, or the decision by a counterparty to request margin securities it is contractually owed under the terms of the hedging instrument). The amount due would be equal to the unrealized loss of the open swap positions with the respective counterparty and could also include other fees and charges. These economic losses will be reflected in our results of operations, and our ability to fund these obligations will depend on the liquidity of our assets and access to capital at the time, and the need to fund these obligations could adversely impact our financial condition.

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

Subject to maintaining our qualification as a REIT and exemption from registration under the 1940 Act, we may pursue various economic hedging strategies to seek to reduce our exposure to adverse changes in interest rates. Our hedging activity varies in scope based on the level and volatility of interest rates, the type of assets held and other changing market conditions. Interest rate hedging may fail to protect or could adversely affect us because, among other things:

- interest rate hedging can be expensive, particularly during periods of rising and volatile interest rates;
- available interest rate hedges may not correspond directly with the interest rate risk for which protection is sought;
- due to a credit loss, the duration of the hedge may not match the duration of the related liability;
- the amount of income that a REIT may earn from hedging transactions (other than hedging transactions that satisfy certain requirements of the Code or that are done through a taxable REIT subsidiary (a “TRS”) to offset interest rate losses is limited by U.S. federal tax provisions governing REITs);
- 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 stockholders’ equity;
- the credit quality of the hedging counterparty owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the hedging counterparty owing money in the hedging transaction may default on its obligation to pay.

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

While the majority of our interest rate swaps are traded on a regulated exchange, certain hedging instruments are traded over the counter and do not trade on regulated exchanges and, therefore, are not guaranteed by an exchange or a clearing house. In addition, over the counter instruments are more lightly regulated by U.S. and foreign governmental authorities. Consequently, there may be no requirements with respect to record keeping, financial responsibility or segregation of customer funds and positions. Furthermore, the enforceability of agreements underlying hedging transactions may depend on compliance with applicable statutory and commodity and other regulatory requirements and, depending on the identity of the counterparty, applicable international requirements. The business failure of a hedging counterparty with whom we enter into a hedging transaction which did not clear through a clearing house would most likely result in its default. Default by a party with whom we enter into a hedging transaction may result in the loss of unrealized profits and force us to cover our commitments, if any, at the then current market price. Although generally we seek to reserve the right to terminate our hedging positions, it may not always be possible to dispose of or close out a hedging position without the consent of the hedging counterparty and we may not be able to enter into an offsetting contract in order to cover our risk. There can be no assurance that a liquid secondary market will exist for any hedging instruments purchased or sold, and we may be required to maintain a position until exercise or expiration, which could result in losses.

Risks associated with our relationship with our Manager

Our Board of Directors has approved very broad investment guidelines for our Manager and does not approve each investment and financing decision made by our Manager.

Our Manager is authorized to follow very broad investment guidelines. Our Board of Directors periodically reviews our investment guidelines and our investment portfolio but does not, and is not required to, review all of our proposed investments, except that an investment in a security structured or issued by another entity managed by our Manager must be approved by at least two-thirds (2/3) of our independent directors prior to such investment. In addition, in conducting periodic reviews, our Board of Directors may rely primarily on information provided to them by our Manager. Furthermore, our Manager may use complex strategies, and transactions entered into by our Manager may be costly, difficult or impossible to unwind by the time they are reviewed by our Board of Directors. Our Manager has great latitude within the broad parameters of our investment guidelines in determining the types and amounts of Agency and Non-Agency RMBS, CMBS, ABS and Whole Loan investments it may decide are attractive investments for us, which could result in investment returns that are substantially below expectations or that result in losses, which would materially and adversely affect our business operations and results. Further, decisions made and investments and financing arrangements entered into by our Manager may not fully reflect the best interests of our stockholders.

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

We are subject to conflicts of interest arising out of our relationship with our Manager. We have only one employee, our Chief Financial Officer (CFO), Robert W. Lehman. All of our executive officers, with the exception of our CFO, and two of our directors, James W. Hirschmann III and Bonnie M. Wongtrakool, are employees of our Manager. Our Management Agreement with our Manager was negotiated between related parties and its terms, including fees and other amounts payable, may not be as favorable to us as if it had been negotiated at arm's-length with an unaffiliated third party. In addition, the obligations of our Manager and its officers and personnel to engage in other business activities may reduce the time our Manager and its officers and personnel spend managing us.

We compete for investment opportunities directly with other client portfolios managed by our Manager. Clients of our Manager have investment mandates and objectives that target the same assets as us. A substantial number of client accounts managed by our Manager have exposure to RMBS, CMBS and other investments, and may have similar investment mandates and objectives. While our Manager has only a limited number of client accounts investing in Whole Loans, the supply of Whole Loan investments meeting the Manager's investment criteria is extremely limited. In addition, our Manager may have additional clients that compete directly with us for investment opportunities in the future. Our Manager has an investment allocation policy in place that is intended to ensure that no single client is intentionally favored over another and that trades are allocated in a fair and equitable manner. We may compete with our Manager or its other clients for investment or financing opportunities sourced by our Manager; however, we may either not be presented with the opportunity or have to compete with our Manager to acquire these investments or have access to these sources of financing. Our Manager and our executive officers may choose to allocate favorable investments to itself or to its or other clients instead of to us. Further, at times when there are turbulent conditions in the mortgage markets or distress in the credit markets or other times when we will need focused support and assistance from our Manager, our Manager's other clients will likewise require greater focus and attention, placing our Manager's resources in high demand. In such situations, we may not receive the level of support and assistance that we may receive if we were internally managed or if our Manager did not act as a manager for other entities. There is no assurance that our Manager's allocation policies that address some of the conflicts relating to our access to investment and financing sources will be adequate to address all of the conflicts that may arise.

We pay our Manager a management fee that is not tied to our performance. The management fee may not sufficiently incentivize our Manager to generate attractive risk-adjusted returns for us. This could hurt both our ability to make distributions to our stockholders and the market price of our common stock. Furthermore, the compensation payable to our Manager will increase as a result of future issuances of our equity securities, even if the issuances are dilutive to existing stockholders.

As of December 31, 2022, our Manager owned 130,079 shares of our common stock. To the extent our Manager elects to sell all or a portion of these shares in the future, our Manager's interests may be less aligned with our interests.

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

We have no separate facilities and are completely reliant on our Manager. Our Manager has significant discretion as to the implementation of our investment and operating policies and strategies. Accordingly, we believe that our success will depend to a significant extent upon the efforts, experience, diligence, skill and network of business contacts of the executive officers and key personnel of our Manager. The executive officers and key personnel of our Manager evaluate, negotiate, close and monitor our investments; therefore, our success depends on their continued service. The departure of any of the executive officers or key personnel of our Manager could have a material adverse effect on our performance. In addition, we offer no assurance that our Manager will remain our investment manager or that we will continue to have access to our Manager's principals and professionals.

The current term of our Management Agreement expires on May 16, 2023, and is automatically renewed and extended for consecutive one-year renewal terms each May 15th unless terminated pursuant to an affirmative vote of at least two-thirds (2/3) of the Company's independent directors at least 180 days in advance of an automatic renewal date. If the Management Agreement is terminated and no suitable replacement is found to manage us, we may not be able to execute our business plan. Moreover, our Manager is not obligated to dedicate any of its personnel exclusively to us, nor is it obligated to dedicate any specific portion of its time to our business, and none of our Manager's personnel are contractually dedicated to us under our Management Agreement with our Manager.

The Management Agreement with our Manager was not negotiated on an arm's-length basis, may not be as favorable to us as if it had been negotiated with an unaffiliated third party and may be costly and difficult to terminate.

All of our executive officers and two of our directors are employees of our Manager. Our Management Agreement with our Manager was negotiated between related parties and its terms, including fees payable, may not be as favorable to us as if it had been negotiated with an unaffiliated third party.

Termination of the Management Agreement with our Manager without cause is difficult and costly. Our independent directors review our Manager's performance and any fees payable to our Manager annually and the Management Agreement may be terminated annually upon the affirmative vote of at least two-thirds (2/3) of our independent directors based upon: (i) our Manager's unsatisfactory performance that is materially detrimental to us; or (ii) our determination that any fees payable to our Manager are not fair, subject to our Manager's right to prevent termination based on unfair fees by accepting a reduction of management fees agreed to by at least two-thirds (2/3) of our independent directors. We are required to provide our Manager 180 days prior notice of any such termination. Unless terminated for cause, we are required to pay our Manager a termination fee equal to three times the average annual management fee earned by our Manager during the prior 24-month period immediately preceding such termination, calculated as of the end of the most recently completed fiscal quarter before the date of termination. This provision increases the effective cost to us of electing not to renew, or defaulting in our obligations under, the Management Agreement, thereby adversely affecting our inclination to end our relationship with our Manager, even if we believe our Manager's performance is not satisfactory.

Pursuant to the Management Agreement, our Manager does not assume any responsibility other than to render the services called for thereunder and is not responsible for any action of our Board of Directors in following or declining to follow its advice or recommendations. Under the terms of the Management Agreement, our Manager, its officers, stockholders, members, managers, directors, personnel, any person controlling or controlled by our Manager and any person providing sub-advisory services to our Manager are not liable to us, our directors, our stockholders or any partners for acts or omissions performed in accordance with and pursuant to the Management Agreement, except because of acts constituting bad faith, willful misconduct, gross negligence, or reckless disregard of their duties under the Management Agreement. In addition, we indemnify our Manager, its officers, stockholders, members, managers, directors, personnel, any person controlling or controlled by our Manager, and any person providing sub-advisory services to our Manager with respect to all expenses, losses, damages, liabilities, demands, charges and claims arising from acts of our Manager not constituting bad faith, willful misconduct, gross negligence, or reckless disregard of duties, performed in good faith in accordance with and pursuant to the Management Agreement.

Our Manager's management fee is payable regardless of our performance.

We pay our Manager a management fee regardless of the performance of our portfolio. Our Manager's entitlement to non-performance-based compensation might reduce its incentive to devote its time and effort to seeking assets that provide attractive risk-adjusted returns for our portfolio. This in turn could hurt both our ability to make distributions to our stockholders and the market price of our common stock.

Our Manager is subject to extensive regulation as an investment advisor, which could adversely affect its ability to manage our business.

Our Manager is subject to regulation as an investment advisor by various regulatory authorities that are charged with protecting the interests of its clients, including us. Instances of criminal activity and fraud by participants in the investment management industry and disclosures of trading and other abuses by participants in the financial services industry have led the U.S. government and regulators to the rules and regulations governing, and oversight of, the U.S. financial system, including the investment management industry and more aggressive enforcement of the existing laws and regulations. Our Manager could be subject to civil liability, criminal liability, or sanction, including revocation of its registration as an investment adviser, revocation of the licenses of its employees, censures, fines, or temporary suspension or permanent bar from conducting business, if it is found to have violated any of these laws or regulations. Any such liability or sanction could adversely affect its ability to manage our business. Our Manager must continually address conflicts between its interests and those of its clients, including us. In addition, the SEC and other regulators have increased their scrutiny of potential conflicts of interest. We believe our Manager has

procedures and controls that are reasonably designed to address these issues. However, appropriately dealing with conflicts of interest is complex and difficult and if our Manager fails, or appears to fail, to deal appropriately with conflicts of interest, it could face litigation or regulatory proceedings or penalties, any of which could adversely affect its ability to manage our business.

Risks related to our common stock

We may pay taxable dividends in our common stock and cash, in which case stockholders may sell shares of our common stock to pay tax on such dividends, placing downward pressure on the market price of our common stock.

We generally must distribute annually at least 90% of our REIT taxable income (subject to certain adjustments and excluding any net capital gain), in order to qualify as a REIT, and any REIT taxable income that we do not distribute will be subject to U.S. corporate income tax at regular rates. The Board of Directors will evaluate dividends in future periods based upon customary consideration, such as our cash balances, cash flows, and market conditions and could consider paying future dividends in shares of common stock, cash, or a combination of shares of common stock and cash.

If we make a taxable dividend payable in cash and common stock, taxable stockholders receiving such dividends will be required to include the full amount of the dividend as ordinary income to the extent of our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. As a result, stockholders may be required to pay income tax with respect to such dividends in excess of the cash dividends received. If a U.S. stockholder sells the common stock that it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our common stock at the time of the sale. Furthermore, with respect to certain non-U.S. stockholders, we may be required to withhold U.S. federal income tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in common stock. If we make a taxable dividend payable in cash and our common stock and a significant number of our stockholders determine to sell shares of our common stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our common stock.

The market price and trading volume of our common stock may vary substantially.

Our common stock is listed on the NYSE under the symbol “WMC.” The stock markets, including the NYSE, have experienced significant price and volume fluctuations currently and over the past several years. As a result, the market price of our common stock is likely to be similarly volatile, and investors in our common stock may experience a decrease in the value of their shares. Accordingly, no assurance can be given as to the ability of our stockholders to sell their common stock or the price that our stockholders may obtain for their common stock.

Some of the factors that could negatively affect the market price of our common stock include:

- actual or anticipated variations in our quarterly operating results;
- changes in our earnings estimates or publication of research reports about us or the real estate industry;
- changes in market valuations of similar companies;
- adverse market reaction to any increased indebtedness we incur in the future;
- additions to or departures of our Manager’s key personnel;
- actions by our stockholders;
- changes in our dividend policy or payments;
- speculation in the press or investment community; and
- adverse shocks in stock and bond market conditions due to inflationary pressures.

Market factors unrelated to our performance could also negatively impact the market price of our common stock. One of the factors that investors may consider in deciding whether to buy or sell our common stock is our distribution rate as a percentage of our stock price relative to market interest rates. If market interest rates increase, prospective investors may seek alternative investments paying higher dividends or interest. As a result, interest rate fluctuations and conditions in the capital markets can affect the market value of our common stock. For instance, if interest rates rise, it is likely that the market price of our common stock will decrease as market rates on interest-bearing securities increase.

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

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

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

We cannot predict the effect, if any, of future sales of our common stock, or the availability of shares for future sales, on the market price of our common stock. The market price of our common stock may decline significantly when the restrictions on resale (or lock up agreements), which may attach to future sales of our common stock, by certain of our stockholders lapse. Sales

of substantial amounts of common stock or the perception that such sales could occur may adversely affect the prevailing market price for our common stock.

Also, we may issue additional shares in follow-on public offerings or private placements to make new investments or for other purposes. We are not required to offer any such shares to existing stockholders on a preemptive basis. Therefore, it may not be possible for existing stockholders to participate in such future share issuances, which may dilute the existing stockholders' interests in us.

We have not established a minimum distribution payment level and we cannot assure you of our ability to pay distributions in the future.

We intend to pay quarterly distributions and to make distributions to our stockholders in an amount such that we distribute all or substantially all of our net taxable income, calculated in accordance with the REIT requirements, each year. We have not established a minimum distribution payment level and our ability to pay distributions may be adversely affected by a number of factors, including the risk factors described herein. All distributions will be made at the discretion of our Board of Directors and will depend on our earnings, our financial condition, debt covenants, maintenance of our REIT qualification, and other factors our Board of Directors may deem relevant from time to time. We believe that a change in any one of the following factors could adversely affect our results of operations and impair our ability to pay distributions to our stockholders:

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

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

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

If we decide to issue debt or equity securities in the future, which would rank senior to our common stock, it is likely that they will be governed by an indenture or other instrument containing covenants restricting our operating flexibility. Additionally, any convertible or exchangeable securities that we issue in the future may have rights, preferences and privileges more favorable than those of our common stock and may result in dilution to owners of our common stock. We and, indirectly, our stockholders, will bear the cost of issuing and servicing such securities. Because our decision to issue debt or equity securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus holders of our common stock will bear the risk of our future offerings reducing the market price of our common stock and diluting the value of their stock holdings in us. Furthermore, the compensation payable to our Manager will increase as a result of future issuances of our equity securities, including issuances upon exercise of the warrants, described below, even if the issuances are dilutive to existing stockholders.

Conversion of our convertible senior unsecured notes may dilute the ownership interest of existing stockholders, including holders who had previously converted their notes.

In September 2021, the Company issued \$86.3 million in aggregate principal of convertible senior unsecured notes due in 2024 (the "2024 Notes") for net proceeds of \$83.4 million. Interest on the 2024 Notes is paid semiannually. The 2024 Notes are convertible into, at the Company's election, cash, shares of the Company's common stock, or a combination of both, subject to the satisfaction of certain conditions and during specified periods. The conversion rate is subject to adjustment upon the occurrence of certain specified events and the holders may require the Company to repurchase all or any portion of their notes for cash equal to 100% of the principal amount of the 2024 Notes, plus accrued and unpaid interest, if the Company undergoes a fundamental change as specified in the supplemental indenture for the 2024 Notes. The post reverse stock split conversion rate is 33.7952 shares of common stock per \$1,000 principal amount of notes and represented a conversion price of \$29.59 per share of common stock. The 2024 Notes mature on September 15, 2024, unless earlier converted, redeemed, or repurchased by the holders pursuant to their terms, and are not redeemable by the Company except during the final three months prior to maturity. To the extent we issue shares of our common stock upon conversion of the 2024 Notes, the conversion of some, or all of our 2024 Notes, will dilute the ownership interests of existing stockholders.

Risks related to our organization and structure

Our authorized but unissued shares of common and preferred stock may prevent a change in our control.

Our amended and restated certificate of incorporation authorizes us to issue additional authorized but unissued shares of common or preferred stock. In addition, our Board of Directors may, without stockholder approval, amend our amended and restated certificate of incorporation to increase the aggregate number of our shares of stock or the number of shares of stock of any class or series that we have authority to issue and classify or reclassify any unissued shares of common or preferred stock and set the preferences, rights and other terms of the classified or reclassified shares. As a result, our Board of Directors may establish

a series of shares of common or preferred stock that could delay or prevent a transaction or a change in control that might involve a premium price for our shares of common stock or otherwise be in the best interest of our stockholders.

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

To maintain our qualification as a REIT, no more than 50% in value of our outstanding capital stock may be owned, directly or indirectly, by five or fewer individuals during the last half of any calendar year. "Individuals" for this purpose include natural persons, private foundations, some employee benefit plans and trusts, and some charitable trusts. To assist us in maintaining our qualification as a REIT, our amended and restated certificate of incorporation generally prohibits any person from directly or indirectly owning more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our capital stock or more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our common stock. This ownership limitation could have the effect of discouraging a takeover or other transaction in which holders of our common stock might receive a premium for their shares over the then prevailing market price or which holders might believe to be otherwise in their best interests.

Provisions in our amended and restated certificate of incorporation, our amended and restated bylaws and Delaware law may have the effect of preventing or hindering a change in control and adversely affecting the market price of our common stock.

Provisions in our amended and restated certificate of incorporation and our amended and restated bylaws and applicable provisions of the Delaware General Corporation Law may make it more difficult and expensive for a third party to acquire control of us even if a change of control would be beneficial to the interests of our stockholders. These provisions could discourage potential takeover attempts and could adversely affect the market price our common stock.

We may pay distributions from offering proceeds, borrowings or the sale of assets to the extent that distributions exceed earnings or cash flow from our operations.

We may pay distributions from offering proceeds, borrowings, or the sale of assets to the extent that distributions exceed earnings or cash flow from our operations. Such distributions would reduce the amount of cash we have available for investing and other purposes and could be dilutive to our financial results. In addition, funding our distributions from our net proceeds may constitute a return of capital to our investors, which would have the effect of reducing each stockholder's basis in its shares of common stock.

Risks related to REIT status

If we do not qualify as a REIT or fail to remain qualified as a REIT, we will be subject to U.S. federal income tax as a regular corporation and could face a substantial tax liability, which would reduce the amount of cash available for distribution to our stockholders.

We believe we have operated and intend to continue to operate in a manner that allows us to qualify as a REIT. Our qualification as a REIT depends on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership, and other requirements on a continuing basis. Our ability to satisfy the asset tests depends upon our analysis of the characterization and fair market values of our assets, some of which are not susceptible to a precise determination, and for which we will not obtain independent appraisals. Our compliance with the annual REIT income and quarterly asset requirements also depends upon our ability to successfully manage the composition of our income and assets on an ongoing basis. Accordingly, there can be no assurance that the IRS will not contend that our interests in our subsidiaries or in securities of other issuers will not cause a violation of the REIT requirements.

If we were to fail to qualify as a REIT in any taxable year, and we do not qualify for certain statutory relief provisions, we would be subject to U.S. federal income tax, on our taxable income at regular corporate rates, and dividends paid to our stockholders would not be deductible by us in computing our taxable income. Any resulting corporate tax liability could be substantial and would reduce the amount of cash available for distribution to our stockholders, which in turn could have an adverse impact on the value of our common stock. Unless we were entitled to relief under certain Code provisions, we also would be disqualified from taxation as a REIT for the four taxable years following the year in which we failed to qualify as a REIT.

Dividends payable by REITs do not qualify for the reduced tax rates available for some dividends.

The maximum tax rate applicable to income from "qualified dividends" payable to U.S. stockholders that are individuals, trusts and estates, is currently 20%, exclusive of the 3.8% investment tax surcharge. Dividends payable by REITs, however, generally are not eligible for the qualified dividend reduced rates. Stockholders that are individuals, trusts, or estates generally may deduct 20% of the aggregate amount of ordinary dividends distributed by us, subject to certain limitations for taxable years beginning after December 31, 2017 and before January 1, 2026. While the qualified dividend rules do not adversely affect the taxation of REITs or dividends payable by REITs, the more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts, and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the stock of REITs, including our common stock.

REIT distribution requirements could adversely affect our ability to execute our business plan.

We generally must distribute at least 90% of our net taxable income annually, determined without regard to the dividends paid deduction and excluding net capital gains, in order for U.S. federal corporate income tax not to apply to earnings that we distribute. To the extent that we satisfy this distribution requirement, but distribute less than 100% of our REIT taxable income, we will be subject to U.S. federal corporate income tax on our undistributed REIT taxable income. In addition, we will be subject to a nondeductible 4% excise tax if the actual amount that we pay out to our stockholders in a calendar year is less than a minimum amount specified under U.S. federal tax laws. We intend to continue to make distributions to our stockholders to comply with the REIT requirements of the Code and avoid corporate income tax and the 4% annual excise tax.

From time to time, we may generate taxable income greater than our income for financial reporting purposes prepared in accordance with U.S. GAAP, or differences in timing between the recognition of taxable income and the actual receipt of cash may occur. For example, the Code limits our ability to use capital losses to offset ordinary income, thereby requiring us to distribute such ordinary income. If we do not have other funds available in these situations we could be required to borrow funds on unfavorable terms, sell investments at disadvantageous prices, or distribute amounts that would otherwise be invested in future acquisitions to make distributions sufficient to enable us to pay out enough of our taxable income to satisfy the REIT distribution requirement and to avoid corporate income tax and the nondeductible 4% excise tax in a particular year. These alternatives could increase our costs or reduce our equity. Thus, compliance with the REIT requirements may hinder our ability to grow, which could adversely affect the value of our common stock.

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

Even if we remain qualified for taxation as a REIT, we may be subject to certain U.S. federal, state, and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, excise taxes, state or local income, property and transfer taxes, such as mortgage recording taxes, and other taxes. In addition, to meet the REIT qualification requirements, prevent the recognition of certain types of non-cash income, and to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from dealer property or inventory, we may hold some of our assets through a TRS or other consolidated entities that will be subject to corporate-level income tax at regular corporate rates. We may also incur a 100% excise tax on transactions with a TRS if they are not conducted on an arm's-length basis. The payment of any of these taxes would decrease cash available for distribution to our stockholders.

Complying with REIT requirements may cause us to liquidate or forgo otherwise attractive opportunities.

To qualify as a REIT, we must ensure that at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, government securities, and qualified real estate assets, including certain mortgage loans and securities. The remainder of our investments in securities (other than government securities, qualified real estate assets and securities issued by a TRS) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our total assets (other than government securities, qualified real estate assets, and securities issued by a TRS) can consist of the securities of any one issuer, and no more than 20% of the value of our total assets can be represented by securities of one or more TRSs. If we fail to comply with these requirements at the end of any calendar quarter, we must correct the failure within 30 days after the end of the calendar quarter, or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate otherwise attractive investments from our investment portfolio. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.

In addition to the asset tests set forth above, to qualify as a REIT, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our stockholders, and the ownership of our stock. We may be required to make distributions to stockholders at disadvantageous times, or when we do not have funds readily available for distribution, and may be unable to pursue investments that would be otherwise advantageous to us in order to satisfy the source-of-income or asset-diversification requirements for qualifying as a REIT. Thus, compliance with the REIT requirements may hinder our ability to make, and in certain cases, to maintain ownership of certain attractive investments.

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

We have acquired, and may acquire in the future, mortgage-backed securities and other portfolio instruments in the secondary market for less than their face amount. In addition, pursuant to our ownership of certain mortgage-backed securities, we may be treated as holding certain debt instruments acquired in the secondary market for less than their face amount. The discount at which such securities or debt instruments are acquired may reflect doubts about their ultimate collectability rather than current market interest rates. The amount of such discount will nevertheless generally be treated as "market discount" for U.S. federal income tax purposes. Under general tax rules, accrued market discount is reported as income when, and to the extent that, any payment of principal of the mortgage-backed security or debt instrument is made. If we collect less on the mortgage-backed security or debt instrument than our purchase price plus the market discount we had previously reported as income, we may not be able to benefit from any offsetting capital loss deductions to the extent we do not have offsetting capital gains.

In addition, pursuant to our ownership of certain mortgage-backed securities or debt instruments, we may be treated as holding distressed debt investments that are subsequently modified by agreement with the borrower. If the amendments to the outstanding debt are "significant modifications" under applicable Treasury regulations, the modified debt may be considered to have been reissued to us at a gain in a debt-for-debt exchange with the borrower. In that event, we may be required to recognize

taxable gain to the extent the principal amount of the modified debt exceeds our adjusted tax basis in the unmodified debt, even if the value of the debt or the payment expectations have not changed.

Moreover, some of the mortgage-backed securities or debt instruments that we acquire may have been issued with original issue discount. Under general tax rules, we are required to report such original issue discount based on a constant yield method and will be taxed based on the assumption that all future projected payments due on such mortgage-backed securities will be made. If such mortgage-backed securities turn out not to be fully collectable, an offsetting loss deduction will become available only in the later year that uncollectability is provable.

Finally, in the event that mortgage-backed securities or any debt instruments we are treated as holding pursuant to our investments in mortgage-backed securities are delinquent as to mandatory principal and interest payments, we may nonetheless be required to continue to recognize the unpaid interest as taxable income as it accrues, despite doubt as to its ultimate collectability. Similarly, we may be required to accrue interest income with respect to subordinate mortgage-backed securities at the stated rate regardless of whether corresponding cash payments are received, or are ultimately collectable. In each case, we would prefer to have an offsetting loss deduction available to us when such interest was determined to be uncollectible, the utility of that deduction could depend on our having taxable income in that later year or thereafter.

Certain apportionment rules may affect our ability to comply with the REIT asset and gross income tests.

The Code provides that a regular or a residual interest in a real estate mortgage investment conduit, or REMIC, is generally treated as a real estate asset for the purpose of the REIT asset tests, and any amount includible in our gross income with respect to such an interest is generally treated as interest on an obligation secured by a mortgage on real property for the purpose of the REIT gross income tests. If, however, less than 95% of the assets of a REMIC in which we hold an interest consist of real estate assets (determined as if we held such assets), we will be treated as holding our proportionate share of the assets of the REMIC for the purpose of the REIT asset tests and receiving directly our proportionate share of the income of the REMIC for the purpose of determining the amount of income from the REMIC that is treated as interest on an obligation secured by a mortgage on real property.

The “taxable mortgage pool” rules may increase the taxes that we or our stockholders may incur, and may limit the manner in which we effect future securitizations.

Securitizations could result in the creation of taxable mortgage pools for U.S. federal income tax purposes. As a REIT, so long as we own 100% of the equity interests in a taxable mortgage pool, we generally would not be adversely affected by the characterization of the securitization as a taxable mortgage pool. Certain categories of stockholders, however, such as foreign stockholders eligible for treaty or other benefits, stockholders with net operating losses, and certain tax-exempt stockholders that are subject to unrelated business income tax, could be subject to increased taxes on a portion of their dividend income from us that is attributable to the taxable mortgage pool. In addition, to the extent that our stock is owned by tax-exempt “disqualified organizations,” such as certain government-related entities and charitable remainder trusts that are not subject to tax on unrelated business income, we may incur a corporate level tax on a portion of our income from the taxable mortgage pool. In that case, we may reduce the amount of our distributions to any disqualified organization whose stock ownership gave rise to the tax. Moreover, we would be precluded from selling equity interests in these securitizations to outside investors, or selling any debt securities issued in connection with these securitizations that might be considered to be equity interests for tax purposes. These limitations may prevent us from using certain techniques to maximize our returns from securitization transactions.

Our ability to invest in and dispose of “to be announced” securities could be limited by our election to be subject to tax as a REIT.

We may purchase Agency RMBS through “to-be-announced” forward contracts, or TBAs. In certain instances, rather than take delivery of the Agency RMBS subject to a TBA, we may dispose of the TBA through a dollar roll transaction in which we agree to purchase similar securities in the future at a predetermined price or otherwise, which may result in the recognition of income or gains. We account for dollar roll transactions as purchases and sales of securities. The law is unclear regarding whether TBAs will be qualifying assets for the 75% asset test and whether income and gains from dispositions of TBAs will be qualifying income for the 75% gross income test. Accordingly, our ability to purchase Agency RMBS through TBAs and to dispose of TBAs, through dollar roll transactions or otherwise, could be limited.

The failure of securities subject to repurchase agreements to qualify as real estate assets could adversely affect our ability to qualify as a REIT.

We enter into financing arrangements that are structured as sale and repurchase agreements pursuant to which we nominally sell certain of our securities to a counterparty and simultaneously enter into an agreement to repurchase these securities at a later date in exchange for a purchase price. Economically, these agreements are financings which are secured by the securities sold pursuant thereto. We believe that we will be treated for REIT asset and income test purposes as the owner of the securities that are the subject of any such sale and repurchase agreement notwithstanding that such agreement may transfer record ownership of the securities to the counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own the securities during the term of the sale and repurchase agreement, in which case we could fail to qualify as a REIT.

Liquidation of assets may jeopardize our REIT qualification or create additional tax liability for us.

To continue to qualify as a REIT, we must comply with requirements regarding the composition of our assets and our sources of income. If we are compelled to liquidate our investments to repay obligations to our lenders, we may be unable to comply with these requirements, ultimately jeopardizing our qualification as a REIT, or we may be subject to a 100% tax on any resulting gain if we sell assets that are treated as dealer property or inventory.

Complying with REIT requirements may limit our ability to hedge effectively and may cause us to incur tax liabilities.

The REIT provisions of the Code substantially limit our ability to hedge our assets and liabilities. Any income from a hedging transaction we enter into to manage risk of interest rate changes with respect to borrowings made or to be made to acquire or carry real estate assets does not constitute “gross income” for purposes of the 75% or 95% gross income tests, provided that certain identification requirements are met. To the extent that we fail to properly identify such transactions as hedges, or enter into other types of hedging transactions, the income from those transactions is likely to be treated as non-qualifying income for purposes of both of the gross income tests. As a result of these rules, we limit our use of advantageous hedging techniques, and we may implement those hedges through a domestic TRS. This could increase the cost of our hedging activities because our TRS would be subject to tax on gains or expose us to greater risks associated with changes in interest rates than we would otherwise want to bear. In addition, losses in our TRS will generally not provide any tax benefit, except for being carried forward against future taxable income in the TRS.

Qualifying as a REIT involves highly technical and complex provisions of the Code.

Qualification as a REIT involves the application of highly technical and complex Code provisions for which only limited judicial and administrative authorities exist. Even a technical or inadvertent violation could jeopardize our REIT qualification. Our qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership, and other requirements on a continuing basis. In addition, our ability to satisfy the requirements to qualify as a REIT depends in part on the actions of third parties over which we have no control or only limited influence.

New legislation or administrative or judicial action, in each instance potentially with retroactive effect, could make it more difficult or impossible for us to qualify as a REIT

The U.S. federal income tax treatment of REITs may be modified, possibly with retroactive effect, by legislative, judicial or administrative action at any time, which could affect the U.S. federal income tax treatment of an investment in us. The U.S. federal income tax rules dealing with REITs constantly are under review by persons involved in the legislative process, the IRS and the U.S. Treasury Department, which results in statutory changes as well as frequent revisions to regulations and interpretations. Revisions in U.S. federal tax laws and interpretations thereof could affect or cause us to change our investments and commitments and affect the tax considerations of an investment in us.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of December 31, 2022, our executive and administrative offices are located in Pasadena, California, in office space shared with our Manager. We do not own any material important physical properties as we rely on our Manager for management services; however, we have real estate owned or REO that we acquire, from time to time, through foreclosures on mortgage loans.

ITEM 3. LEGAL PROCEEDINGS

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is listed and traded on the NYSE under the symbol WMC. At March 10, 2023, our common stock was held by approximately 7 holders of record. At March 10, 2023, there were 6,038,012 shares of common stock outstanding.

The following table presents cash dividends declared and paid by the Company on its common stock, not adjusted on a retroactive basis to reflect the Company’s one-for-ten reverse stock split to align with 1099-DIV per share amounts as reported.

Declaration Date	Record Date	Payment Date	Common Stock Dividend
2022			
12/21/2022	01/03/2023	01/26/2023	\$0.40
09/22/2022	10/03/2022	10/26/2022	\$0.40
06/21/2022	07/01/2022	07/25/2022	\$0.04
<u>03/23/2022</u>	<u>04/04/2022</u>	<u>04/26/2022</u>	<u>\$0.04</u>
2021			
12/21/2021	12/31/2021	01/26/2022	\$0.06
09/23/2021	10/04/2021	10/26/2021	\$0.06
06/22/2021	07/02/2021	07/26/2021	\$0.06
03/23/2021	04/02/2021	04/26/2021	\$0.06

In order to maintain our qualification as a REIT, we must make annual distributions to our stockholders of at least 90% of our taxable income (not including net capital gains). We have adopted a policy of paying regular quarterly dividends on our common stock. Refer to Note 12, “Stockholders’ Equity” to the financial statements contained in this Annual report on Form 10-K for details on the tax characterization of our dividend.

A combination of cash and stock dividends has been paid on our common stock since our initial public offering. Dividends are declared at the discretion of the Board of Directors and depend on actual and anticipated cash from operations, our financial condition, capital requirements, the annual distribution requirements under the REIT provisions of the Internal Revenue Code, and other factors the Board of Directors may consider relevant.

Securities Authorized for Issuance Under Equity Compensation Plans

At the Annual Meeting of Stockholders held on June 24, 2022, the Company’s stockholders approved the Western Mortgage Capital Corporation 2022 Omnibus Incentive Plan and the Western Asset Mortgage Capital Corporation 2022 Manager Omnibus Incentive Plan (collectively, the “2022 Plans”). The 2022 Plans provide for issuance of options (including non-statutory stock options, and incentive stock options), stock appreciation rights (referred to as SARs), restricted stock, restricted stock units (referred to as RSUs), stock bonuses, other stock based awards, and cash awards. For further details, see Note 11, “Share-Based Payments” to the Consolidated Financial Statements included under Item 8 in this Annual Report on Form 10-K.

The following table presents certain information about the 2022 Plans as of December 31, 2022:

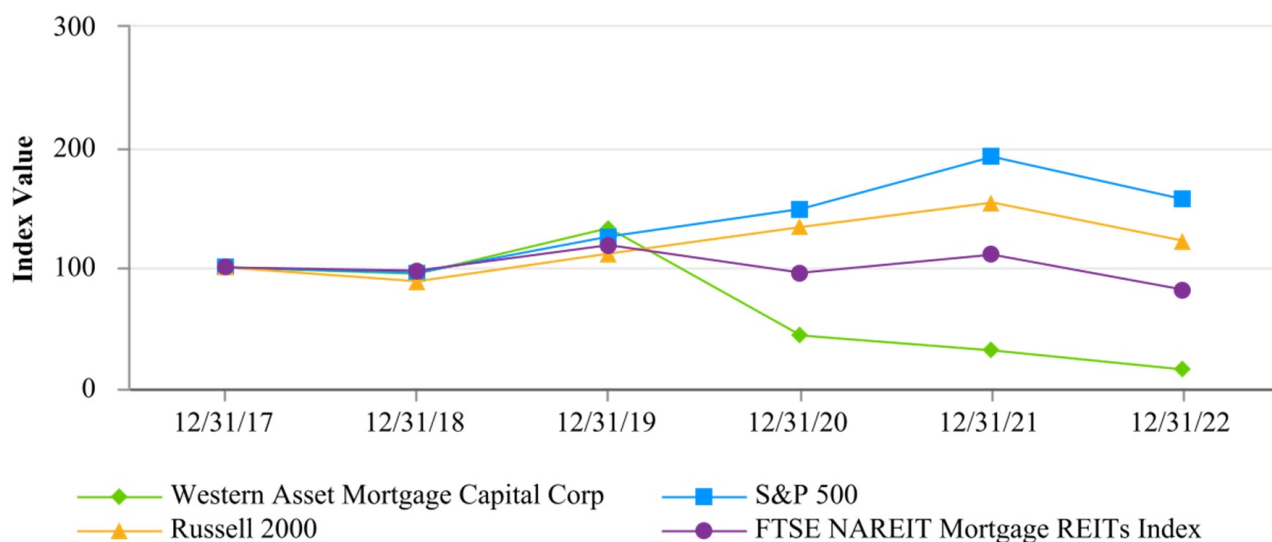
<u>Award</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights</u>	<u>Weighted-average exercise price of outstanding options, warrants and rights</u>	<u>Number of securities remaining available for future issuance under 2022 Plans</u>
Restricted common stock	N/A	N/A	52,902
Total	N/A	N/A	52,902

Stockholder Return Performance

The following graph is a comparison of the cumulative total stockholder return on the Company’s common stock, the Standard & Poor’s 500 Index (the “S&P 500 Index”), the Russell 2000 Index (the “Russell 2000”), and the FTSE NAREIT Mortgage REITs Index (the “FTSE Mortgage REIT”), a peer group index for a five-year period from December 31, 2017 to December 31, 2022, and accordingly does not take into account the dividend the Company declared on December 21, 2022 and paid on January 26, 2023. The graph assumes that \$100 was invested on December 31, 2017 in the Company’s common stock, the S&P 500 Index, the Russell 2000, and the FTSE Mortgage REIT, and that all dividends were reinvested without the payment of any commissions.

There can be no assurance that the performance of the Company’s shares will continue in line with the same or similar trends depicted in the graph below.

Total Return Performance



<u>Index</u>	<u>12/31/2017</u>	<u>12/31/2018</u>	<u>12/31/2019</u>	<u>12/31/2020</u>	<u>12/31/2021</u>	<u>12/31/2022</u>
Western Asset Mortgage Capital Corp.....	\$ 100.00	\$ 95.16	\$ 133.16	\$ 43.84	\$ 30.98	\$ 15.25
S&P 500 Index	\$ 100.00	\$ 95.62	\$ 125.72	\$ 148.85	\$ 191.58	\$ 156.88
Russell 2000 Index	\$ 100.00	\$ 88.99	\$ 111.70	\$ 134.00	\$ 153.85	\$ 122.41
FTSE NAREIT Mortgage REITs Index ...	\$ 100.00	\$ 97.48	\$ 118.27	\$ 96.07	\$ 111.09	\$ 81.53

Recent Sales of Unregistered Securities: Use of Proceeds from Registered Securities

Not applicable.

Purchase of Equity Securities by the Issuer

On December 21, 2021, the Board of Directors of the Company reauthorized its repurchase program of up to 300,000 shares of its common stock through December 31, 2023 adjusted for the ten-for-one reverse stock split. Purchases made pursuant to the program will be made in the open market, in privately negotiated transactions, or pursuant to any trading plan that may be adopted in accordance with Rules 10b5-1 and 10b-18 of the Securities and Exchange Commission. The authorization does not obligate the Company to acquire any particular amount of common shares and the program may be suspended or discontinued at the Company’s discretion without prior notice.

During the twelve months ended December 31, 2022, the Company did not repurchase any shares under the stock repurchase program.

ITEM 6. RESERVED

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion provides the reader a narrative from the perspective of management and should be read in conjunction with our consolidated financial statements and related notes included in Item 8, "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

Overview

Western Asset Mortgage Capital Corporation, a Delaware corporation, commenced operations in May 2012, focused on investing in, financing, and managing a diversified portfolio of real estate related securities, whole loans, and other financial assets, which we collectively refer to as our target assets. Our investment strategy is based on our Manager's perspective of which mix of our target assets it believes provides us with the best risk-reward opportunities at any given time. Our objective is to provide attractive risk adjusted returns to our stockholders primarily through an attractive dividend, which we intend to support with sustainable distributable earnings (which we previously referred to as core earnings), as well as the potential for higher returns through capital appreciation.

Factors Impacting Our Operating Results

Our results of operations are affected by several factors. They primarily depend on, among other things, the level of interest income and market value of our investments, the supply of and demand for the target assets in which we invest, and the financing and other costs associated with our business. Interest income and borrowing costs may vary due to changes in interest rates and the availability of financing, each of which could impact the net interest income we receive on our investments. Also, our operating results may be affected by conditions in the financial markets, such as unanticipated credit events experienced by our investment portfolio.

Changes in market interest rates. With respect to our business operations, increases in interest rates, in general, may over time cause: (i) the interest expense associated with variable rate borrowings to increase; (ii) the value of certain of our assets to decline; (iii) to the extent applicable under the terms of our investments, prepayments on our investments to slow; and (iv) to the extent that we enter into interest rate swap agreements as part of our hedging strategy, the value of these agreements to increase.

Conversely, decreases in interest rates, in general, may over time cause: (i) the interest expense associated with variable rate borrowings to decrease; (ii) the value of certain of our investments to increase; (iii) to the extent applicable under the terms of our investments, prepayments on our investments to increase, and (iv) to the extent that we enter into interest rate swap agreements as part of our hedging strategy, the value of these agreements to decrease.

Credit risk. One of our strategic focuses is acquiring assets which are believed to be of high credit quality. Management believes this strategy will generally keep credit losses and financing costs low. However, we are subject to varying degrees of credit risk in connection with our target assets. Our Manager seeks to mitigate this risk by seeking to acquire high quality assets, at appropriate prices given anticipated and unanticipated losses and by deploying a value-driven approach to underwriting and diligence, consistent with our Manager's historical investment strategy. However, unanticipated credit losses could occur which could adversely impact operating results.

Size of portfolio. The size of our portfolio of assets is a key revenue driver. Generally, as the size of our portfolio grows, the amount of interest income earned increases, and conversely as the size of our portfolio declines, the amount of interest income earned will decline.

Market conditions. With respect to our business operations, adverse changes in market conditions, in general, may over time cause: (i) increased volatility of certain assets; (ii) the value of certain of our assets to decline; (iii) to the extent applicable under the terms of our investments, prepayments on our investments to slow; and, (iv) the cost to borrow against certain assets to increase.

Conversely, positive changes in market conditions, in general, may over time cause: (i) decreased volatility of certain assets; (ii) the value of certain of our assets to increase; (iii) to the extent applicable under the terms of our investments, prepayments on our investments to increase, and (iv) the cost to borrow against certain assets to decline.

See Item 1A. "Risk Factors" of this Annual Report on Form 10-K for additional factors that may impact our operating results.

Proposed Changes to LIBOR

The FASB issued Accounting Standards Update 2020-04 ("ASU") to provide optional expedients and exceptions for applying U.S. GAAP to contract modifications, hedging relationships, and other transactions affected by the anticipated transition away from LIBOR. In 2020, the FASB issued ASU 2020-04, which provides optional guidance for a limited period of time to ease the potential burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting. At the time that ASU 2020-04 was issued, the UK Financial Conduct Authority ("FCA") had established its intent that it would no longer be necessary to persuade, or compel, banks to submit to LIBOR after December 31, 2021. As a result, a sunset provision for the optional guidance in Topic 848 was originally set for December 31, 2022, one year after the expected cessation date of all currencies and tenors of LIBOR.

In March 2021, the FCA announced that the intended cessation date of the overnight 1-, 3-, 6-, and 12-month tenors of USD LIBOR would be June 30, 2023, which was beyond the current sunset date of Topic 848. Accordingly, during December 2022, the FASB issued ASU 2022-06 to defer the sunset date of ASC Topic 848, Reference Rate Reform, which provides temporary optional relief in accounting for the impact of reference rate reform from December 31, 2022, to December 31, 2024, after which entities will no longer be permitted to apply the relief in Topic 848. The amendments apply to all entities that have contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform.

As such, with the additional time granted to apply the relief in Topic 848 extended through December 31, 2024, management will monitor the legacy LIBOR reference rate contracts outstanding as of December 31, 2022, as either they will terminate prior to the June 30, 2023 LIBOR cessation date currently set by the FCA, or the Company will use the practical expedients per Topic 848 to account for modifications to contracts prospectively within the scope of Topics 310, Receivables, and 470, Debt, as a continuation of the existing contract, as long as no modifications effecting maturity or other terms are modified. The Company will adjust the effective interest rate of all contracts, hedging relationships, and other transactions that reference LIBOR to revised reference rates and spreads as they occur. The variable- and floating-rate note sectors have primarily transitioned away from LIBOR as the market has already adapted to the secured overnight financing rate (SOFR), as the primary index used by issuers.

Critical Accounting Policies

The consolidated financial statements include our accounts, those of our wholly-owned subsidiaries, and certain variable interest entities (“VIEs”) in which we are the primary beneficiary. All intercompany amounts have been eliminated in consolidation. In accordance with GAAP, our consolidated financial statements require 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 will 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 have been based were reasonable at the time made and based upon information available to us at that time. For a review of recent accounting pronouncements that may impact our results of operations, refer to Note 2, “Summary of Significant Accounting Policies” to the consolidated financial statements contained in this Annual Report on Form 10-K.

Valuation of Financial Instruments

We disclose the fair value of our financial instruments according to a fair value hierarchy (Levels I, II, and III, as defined below). ASC 820 “Fair Value Measurements and Disclosures” establishes a framework for measuring fair value and expands financial statement disclosure requirements for fair value measurements. ASC 820 further specifies a hierarchy of valuation techniques, which is based on whether the inputs into the valuation technique are observable or unobservable. The hierarchy is as follows:

Level I — Quoted prices in active markets for identical assets or liabilities.

Level II — Quoted prices for similar assets and liabilities 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.

Level III — Prices are determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable, for example, when there is little or no market activity for an investment at the end of the period, unobservable inputs may be used.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Transfers between levels are determined by us at the end of the reporting period.

Mortgage-Backed Securities and Other Securities

Our mortgage-backed securities and other securities portfolio primarily consists of Agency RMBS, Non-Agency RMBS, Agency CMBS, Non-Agency CMBS, ABS and other real estate related assets. These investments are recorded in accordance with ASC 320, “Investments - Debt and Equity Securities”, ASC 325-40, “Beneficial Interests in Securitized Financial Assets”, or ASC 310-30, “Loans and Debt Securities Acquired with Deteriorated Credit Quality”. We have chosen to make a fair value election pursuant to ASC 825, “Financial Instruments” for our mortgage-backed securities and other securities portfolio. Electing the fair value option allows us to record changes in fair value in the Consolidated Statements of Operations as a component of “Unrealized loss, net”.

Residential Whole Loans

Investments in Residential Whole Loans are recorded in accordance with ASC 310-20, “Nonrefundable Fees and Other Costs”. We have chosen to make the fair value election pursuant to ASC 825 for our entire Residential Whole Loan portfolio. Residential Whole Loans are recorded at fair value with periodic changes in fair market value being recorded in earnings as a component of “Unrealized loss, net”. All other costs incurred in connection with acquiring Residential Whole Loans or committing to purchase these loans are charged to expense as incurred.

Securitized Commercial Loans

Securitized commercial loans are comprised of commercial loans of consolidated variable interest entities which were sponsored by third parties. These loans are recorded in accordance with ASC 310-20, "Nonrefundable Fees and Other Costs". We have chosen to make the fair value election pursuant to ASC 825. Accordingly, these loans are recorded at fair value with periodic changes in fair value being recorded in earnings as a component of "Unrealized loss, net".

Commercial Loans

Investments in Commercial Loans, which are comprised of commercial mortgage loans and commercial mezzanine loans, are recorded in accordance with ASC 310-20, "Nonrefundable Fees and Other Costs". We have chosen to make the fair value election pursuant to ASC 825 for our Commercial Loan portfolio. Accordingly, these loans are recorded at fair value with periodic changes in fair value being recorded in earnings as a component of "Unrealized loss, net". All other costs incurred in connection with acquiring the Commercial Loans or committing to purchase these loans are charged to expense as incurred.

Interest Income Recognition

Agency MBS, Non-Agency MBS, and other securities, excluding Interest-Only Strips, rated AA and higher at the time of purchase

Interest income on mortgage-backed and other securities is accrued based on the respective outstanding principal balances and corresponding contractual terms. We record interest income in accordance with ASC subtopic 835-30, "Imputation of Interest", using the effective interest method. As such premiums and discounts associated with Agency MBS, Non-Agency MBS, and other securities, excluding Interest-Only Strips, are amortized into interest income over the estimated life of such securities. Adjustments to premium and discount amortization are made for actual prepayment activity. We estimate prepayments at least quarterly for our securities and, as a result, if the projected prepayment speed increases, we will accelerate the rate of amortization on premiums or discounts and make a retrospective adjustment to historical amortization. Alternatively, if projected prepayment speeds decrease, we will reduce the rate of amortization on the premiums or discounts and make a retrospective adjustment to historical amortization.

Non-Agency MBS and other securities that are rated below AA at the time of purchase and Interest-Only Strips that are not classified as derivatives

Interest income on Non-Agency MBS and other securities that are rated below AA at the time of purchase and Interest-Only Strips that are not classified as derivatives are also recognized in accordance with ASC 835, using the effective yield method. The effective yield on these securities is based on the projected cash flows from each security, which is estimated based on our observation of the then current information and events, where applicable, and will include assumptions related to interest rates, prepayment rates, and the timing and amount of credit losses. On at least a quarterly basis we review, and if appropriate, make adjustments to our cash flow projections based on input and analysis received from external sources, internal models, and our judgment about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in the yield/interest income recognized on such securities. Actual maturities of the securities are affected by the contractual lives of the underlying collateral, periodic payments of scheduled principal, and prepayments of principal. Therefore, actual maturities of the securities will generally be shorter than stated contractual maturities.

We adopted ASU 2016-13 beginning January 1, 2020. The ASU requires a company to measure credit loss using an expected credit loss model. We elected the fair value option for our investments and as such does not apply the expected loss model instead we record changes in fair value of these investment in the Consolidated Statements of Operations as a component of "Unrealized loss, net". For the purposes of calculating interest income, to ensure that a projected credit loss of a security does not impact the effective yield and interest income we maintain a "shadow allowance" account. We use the shadow allowance to create a management basis. The management basis which is the difference between the net present value of projected cash flows less shadow allowance amount. The shadow allowance and the management basis are operational accounts that are used solely for the purposes of determining and calculating accretable yield and accretable book value and are not recorded in the consolidated financial statements. The management basis is limited to a fair market value of the investment. Actual realized loss on a security is recorded as a reduction in both the management basis and the amortized cost basis. Interest income is computed using the amortized basis as the reference amount and applying the yield calculated using management basis.

Loan Portfolio

Interest income on our residential loan portfolio and commercial loan portfolio is recorded using the effective interest method based on the contractual payment terms of the loan. Any premium amortization or discount accretion will be reflected as a component of "Interest income" in our Consolidated Statements of Operations.

Income recognition is suspended for loans at the earlier of the date at which payments become 90-days past due or when, in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, contractual interest is recorded as interest income when received, under the cash basis method until an accrual is resumed when the loan becomes contractually current and performance is demonstrated.

Variable Interest Entities (“VIEs”)

VIEs are defined as entities that by design either lack sufficient equity for the entity to finance its activities without additional subordinated financial support or are unable to direct the entity’s activities or are not exposed to the entity’s losses or entitled to its residual returns. We evaluate all of our interests in VIEs for consolidation. When the interests are determined to be variable interests, we assess whether we are deemed the primary beneficiary. The primary beneficiary of a VIE is determined to be the party that has both the power to direct the activities of a VIE that most significantly impact the VIE’s economic performance, and the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE.

To assess whether we have the power to direct the activities of a VIE that most significantly impact the VIE’s economic performance, we consider all facts and circumstances, including our role in establishing the VIE and our ongoing rights and responsibilities. This assessment includes first, identifying the activities that most significantly impact the VIE’s economic performance; and second, identifying which party, if any, has power over those activities. In general, the parties that make the most significant decisions affecting the VIE or have the right to unilaterally remove those decision makers is deemed to have the power to direct the activities of a VIE.

To assess whether we have the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, we consider all of our economic interests. This assessment requires that we apply judgment in determining whether these interests, in the aggregate, are considered potentially significant to the VIE. Factors considered in assessing significance include; the design of the VIE, including its capitalization structure, subordination of interests, payment priority, relative share of interests held across various classes within the VIE’s capital structure, and the reasons why the interests are held by us.

In instances where we and our related parties have variable interests in a VIE, we consider whether there is a single party in the related party group that meets both the power and losses or benefits criteria on its own as though no related party relationship existed. If one party within the related party group meets both these criteria, such reporting entity is the primary beneficiary of the VIE and no further analysis is needed. If no party within the related party group on its own meets both the power and losses or benefits criteria, but the related party group as a whole meets these two criteria, the determination of primary beneficiary within the related party group requires significant judgment. The analysis is based upon qualitative as well as quantitative factors, such as the relationship of the VIE to each of the members of the related-party group, as well as the significance of the VIE’s activities to those members, with the objective of determining which party is most closely associated with the VIE. Ongoing assessments of whether an enterprise is the primary beneficiary of a VIE is required.

2022 Activity

Investment Activity

We continually evaluate potential investments and our investment selection is based on supply and demand of our target assets, costs of financing, and the expected future interest rate volatility costs of hedging. As part of our investment focus on residential real estate-related investments, during the twelve months ended December 31, 2022, we acquired \$411.9 million of Residential Whole Loans and \$40.0 million of Non-Agency RMBS. Also, along with the other investors, we sold a Commercial REO for total proceeds of \$54.7 million.

The following table presents our investing activity for the year ended December 31, 2022 (dollars in thousands):

Investment Type	Balance at December 31, 2021	Purchases	Loan Modification/ Capitalized Interest	Principal Payments and Basis Recovery	Proceeds from Sales	Transfers to REO	Realized Gain/(Loss)	Unrealized Gain/(loss)	Premium and discount amortization, net	Balance at December 31, 2022
Agency RMBS and Agency RMBS IOs	\$ 1,172	\$ —	N/A	\$ (103)	\$ —	N/A	\$ —	\$ (302)	\$ —	\$ 767
Non-Agency RMBS	27,769	39,952	N/A	(1,011)	(31,790)	N/A	(2,396)	(9,197)	359	23,686
Non-Agency CMBS	105,358	—	N/A	(6,554)	(10,152)	N/A	(43,935)	40,104	615	85,436
Other securities ⁽¹⁾	51,648	—	N/A	—	(14,485)	N/A	(2,252)	(7,923)	274	27,262
Total MBS and other securities	185,947	39,952	N/A	(7,668)	(56,427)	N/A	(48,583)	22,682	1,248	137,151
Residential Whole Loans	1,023,502	411,919	96	(216,135)	(11,736)	(2,256)	(101)	(108,207)	(5,937)	1,091,145
Residential Bridge Loans	5,428	—	—	(2,670)	—	—	—	91	—	2,849
Commercial Loans	130,572	—	—	(20,593)	—	—	—	(19,977)	—	90,002
Securitized commercial loans	1,355,808	—	—	—	—	—	—	(297,343)	26,638	1,085,103
REO	43,607	—	—	—	(55,573)	2,255	11,966	—	—	2,255
Total Investments	\$ 2,744,864	\$ 451,871	\$ 96	\$ (247,066)	\$ (123,736)	\$ (1)	\$ (36,718)	\$ (402,754)	\$ 21,949	\$ 2,408,505

(1) Other securities include \$22.3 million of GSE CRTs and \$4.9 million of ABS at December 31, 2022

Portfolio Characteristics

Residential Whole Loans

The Residential Whole Loans have low LTV's and are comprised of 2,938 Non-QM adjustable rate mortgages and five investor fixed rate mortgages. The following table presents certain information about our Residential Whole Loans investment portfolio as of December 31, 2022 (dollars in thousands):

Current Coupon Rate	Number of Loans	Principal Balance	Weighted Average				
			Original LTV	Original FICO Score ⁽¹⁾	Expected Life (years)	Contractual Maturity (years)	Coupon Rate
2.01% - 3.00%.....	39	\$ 22,277	66.3%	758	8.9	28.3	2.9%
3.01% - 4.00%.....	402	214,402	66.3%	759	7.3	28.5	3.7%
4.01% - 5.00%.....	1,337	453,811	64.1%	749	5.5	26.0	4.6%
5.01% - 6.00%.....	901	363,197	65.6%	742	4.7	26.7	5.4%
6.01% - 7.00%.....	249	105,933	69.9%	742	3.6	28.4	6.4%
7.01% - 8.00%.....	15	5,681	75.2%	730	3.0	29.2	7.4%
Total	2,943	\$ 1,165,301	65.6%	748	5.5	27.0	4.8%

(1) The original FICO score is not available for 231 loans with a principal balance of approximately \$76.6 million at December 31, 2022. We have excluded these loans from the weighted average computations.

Residential Bridge Loans

We are no longer allocating capital to Residential Bridge Loans. The following table presents certain information about the remaining five Residential Bridge Loans left in the portfolio at December 31, 2022 (dollars in thousands):

Current Coupon Rate	Number of Loans	Principal Balance	Weighted Average		
			Original LTV	Contractual Maturity (months) ⁽¹⁾	Coupon Rate
7.01% – 9.00%.....	2	\$ 1,822	67.5%	N/A	8.7%
9.01% – 11.00%.....	1	849	90.5%	0.0	10.0%
11.01% – 13.00%.....	2	495	69.7%	0.0	11.4%
Total	5	\$ 3,166	74.0%	0.0	9.5%

(1) Non-performing loans that are past their maturity date are excluded from the calculation of the weighted average contractual maturity. The weighted average contractual maturity for these loans is zero.

Non-performing Residential Loans

The following table presents the aging of the Residential Whole Loans and Residential Bridge Loans as of December 31, 2022 (dollars in thousands):

	Residential Whole Loans			Residential Bridge Loans		
	No of Loans	Principal	Fair Value	No of Loans	Principal	Fair Value
Current	2,910	\$ 1,147,412	\$ 1,074,409	—	\$ —	\$ —
1-30 days.....	14	6,983	6,678	—	—	—
31-60 days.....	—	—	—	—	—	—
61-90 days.....	6	2,165	2,032	—	—	—
90+ days.....	13	8,741	8,026	5	3,166	2,849
Total	2,943	\$ 1,165,301	\$ 1,091,145	5	\$ 3,166	\$ 2,849

Residential Whole Loans in Non-Accrual Status

As of December 31, 2022, there were 13 Non-QM loans carried at fair value in non-accrual status with an unpaid principal balance of approximately \$8.7 million and a fair value of approximately \$8.0 million. These nonperforming loans represent approximately 0.8% of the total outstanding principal balance. No allowance or provision for credit losses was recorded as of and for the year ended December 31, 2022, since the valuation adjustment, if any, would be reflected in the fair value of these loans. We stopped accruing interest income for these loan when they became contractually 90 days delinquent. As of December 31, 2022, we had no Non-QM loans in forbearance.

As of December 31, 2022, we had five Residential Bridge Loans remaining in the portfolio and five were in non-accrual status with an unpaid principal balance of approximately \$3.2 million and a fair value of \$2.8 million. No allowance and provision for credit losses was recorded for loans carried at fair value as of and for the year ended December 31, 2022, since valuation adjustments, if any, would be reflected in the fair value of these loans. We stopped accruing interest income for these loans when they became contractually 90 days delinquent.

As of December 31, 2022, we had one real estate owned (“REO”) property with an aggregate carrying value of \$2.3 million related to a foreclosed Residential Whole Loan. The REO property is held for sale and accordingly carried at the lower of cost or fair value less cost to sell. The REO property is classified in “Other assets” in the Consolidated Balance Sheet.

Non-Agency RMBS

The following table presents the fair value and weighted average purchase price for each of our Non-Agency RMBS categories, together with certain of their respective underlying loan collateral attributes and current performance metrics as of December 31, 2022 (fair value dollars in thousands):

Category	Fair Value	Purchase Price	Life (Years)	Weighted Average		60+ Day Delinquent	6-Month CPR
				Original LTV	Original FICO		
Prime	\$ 12,000	\$ 79.78	11.9	67.8%	748	1.2%	17.9%
Alt-A	11,687	50.30	17.3	81.3%	661	17.5%	8.0%
Total	<u>\$ 23,687</u>	<u>\$ 65.24</u>	<u>14.5</u>	<u>74.5%</u>	<u>705</u>	<u>9.2%</u>	<u>13.0%</u>

Agency RMBS Portfolio

The following table summarizes our Agency portfolio by investment category as of December 31, 2022 (dollars in thousands):

	Principal Balance	Amortized Cost	Fair Value	Net Weighted Average Coupon
Agency RMBS IOs and IIOs ⁽¹⁾	N/A	\$ 58	\$ 53	—%
Agency RMBS IOs and IIOs accounted for as derivatives ⁽¹⁾	N/A	N/A	714	0.1%
Total	<u>\$ —</u>	<u>\$ 58</u>	<u>\$ 767</u>	<u>0.1%</u>

(1) IOs and IIOs have no principal balances and bear interest based on a notional balance. The notional balance is used solely to determine interest distributions on the interest-only class of securities.

Non-Agency CMBS

The following table presents certain characteristics of our Non-Agency CMBS portfolio as of December 31, 2022 (dollars in thousands):

Type	Vintage	Principal Balance	Fair Value	Weighted Average	
				Life (Years)	Original LTV
Conduit:	2006-2009	\$ 69	\$ 67	0.6	88.7%
	2010-2020	14,982	10,414	6.0	62.3%
		<u>15,051</u>	<u>10,481</u>	<u>6.0</u>	<u>62.5%</u>
Single Asset:	2010-2020	94,215	74,954	1.1	65.3%
	Total	<u>\$ 109,266</u>	<u>\$ 85,435</u>	<u>1.7</u>	<u>65.0%</u>

Commercial Loans

The following table presents our commercial loan investments as of December 31, 2022 (dollars in thousands):

Loan	Loan Type	Principal Balance	Fair Value	Original LTV	Interest Rate	Maturity Date	Extension Option	Collateral	Geographic Location
CRE 3.....	Interest-Only Mezzanine loan	\$ 90,000	\$ 8,777	58%	1-Month LIBOR plus 9.25%	6/29/2021	None ⁽¹⁾	Entertainment and Retail	NJ
CRE 4.....	Interest-Only First Mortgage	22,204	22,050	63%	1-Month SOFR plus 3.38%	8/6/2025 ⁽²⁾	None	Retail	CT
CRE 5.....	Interest-Only First Mortgage	24,535	24,433	62%	1-Month LIBOR plus 3.75%	11/6/2023 ⁽³⁾	One - 12 month extension	Hotel	NY
CRE 6.....	Interest-Only First Mortgage	13,207	13,151	62%	1-Month LIBOR plus 3.75%	11/6/2023 ⁽³⁾	One - 12 month extension	Hotel	CA
CRE 7.....	Interest-Only First Mortgage	7,259	7,229	62%	1-Month LIBOR plus 3.75%	11/6/2023 ⁽³⁾	One - 12 month extension	Hotel	IL, FL
SBC 3.....	Interest-Only First Mortgage	14,362	14,362	49%	One-Month LIBOR plus 4.35%	1/6/2023	None	Nursing Facilities	CT
		\$ 171,567	\$ 90,002						

(1) CRE 3 is in default and not eligible for extension.

(2) The CRE 4 loan was granted a 3 year extension through August 6, 2025, with a principal pay down of \$16.2 million.

(3) CRE 5, 6, and 7 were each granted one-year extensions through November 6, 2023 and expected to transition from LIBOR during Q2 2023.

Commercial Loan Payoffs

On September 16, 2022, CRE 8, with an outstanding principal balance of \$4.4 million collateralized by assisted living facilities, was paid off in full.

Non-Performing Commercial Loan

CRE 3 Loan

As of December 31, 2022, the CRE 3 junior mezzanine loan with an outstanding principal balance of \$90.0 million was non-performing and past its maturity date of June 29, 2021. Subsequent to the balance sheet date, on February 3, 2023, the CRE 3 loan was sold to an unaffiliated third party for its fair value at December 31, 2022 of \$8.8 million. Refer to Note 6, "Commercial Loans" to the consolidated financial statements contained in this Annual Report on Form 10-K for details.

The following table presents the aging of the Commercial Loans as of December 31, 2022 (dollars in thousands):

	Commercial Loans		
	No of Loans	Principal	Fair Value
Current	5	\$ 81,567	\$ 81,225
1-30 days	—	—	—
31-60 days	—	—	—
61-90 days	—	—	—
90+ days	1	90,000	8,777
Total	6	\$ 171,567	\$ 90,002

Commercial Real Estate Owned

In February 2022, we and the other investors sold the unencumbered hotel property for \$55.9 million which was foreclosed on in the third quarter of 2021. We and the other investors fully recovered our aggregate initial investment of \$42.0 million. We recognized a gain on sale of approximately \$12.2 million.

Geographic Concentration

The mortgages underlying our Non-Agency RMBS and Non-Agency CMBS are located in various states across the United States and other countries. The following table presents the five largest concentrations by location for the mortgages collateralizing our Non-Agency RMBS and Non-Agency CMBS as of December 31, 2022, based on fair value (dollars in thousands):

	Non-Agency RMBS			Non-Agency CMBS	
	Concentration	Fair Value		Concentration	Fair Value
California	28.4%	\$ 6,731	California.....	42.8%	\$ 36,539
Florida	11.5%	2,726	Nevada.....	23.2%	19,782
New York.....	7.0%	1,659	Bahamas	15.0%	12,787
Texas.....	4.2%	985	Texas	3.7%	3,124
New Jersey	3.3%	789	Ohio.....	2.1%	1,802

The following table presents the various states across the United States in which the collateral securing our Residential Whole Loans and Residential Bridge Loans at December 31, 2022, based on principal balance, is located (dollars in thousands):

	Residential Whole Loans			Residential Bridge Loans	
	Concentration	Principal Balance		Concentration	Principal Balance
California	66.8%	\$ 778,732	California.....	55.4%	\$ 1,754
New York.....	9.3%	108,108	New York.....	42.2%	1,337
Texas.....	4.8%	56,126	New Jersey.....	2.4%	75
Florida	4.1%	47,681	Total.....	100.0%	\$ 3,166
Georgia.....	3.5%	40,845			
Other	11.5%	133,809			
Total	100.0%	\$ 1,165,301			

Financing Activity

We will look to continue to expand and diversify our financing sources, especially those sources that provide an alternative to short-term repurchase agreements with daily margin requirements.

Repurchase Agreements

Our repurchase agreements bear interest at a contractually agreed-upon rate and have terms ranging from one month to 12 months. Our counterparties generally require collateral in excess of the loan amount, or haircuts. As of December 31, 2022, the contractual haircuts required under repurchase agreements on our investments were as follows:

	Minimum	Maximum
Short-Term Borrowings		
Agency RMBS IOs	25%	25%
Non-Agency RMBS	35%	40%
Residential Bridge Loans	25%	25%
Other Securities.....	60%	60%
Long-Term Borrowings		
<u>Non-Agency CMBS and Non-Agency RMBS Facility</u>		
Non-Agency RMBS	35%	40%
Non-Agency CMBS	22%	40%
Other securities	60%	60%
<u>Residential Whole Loan Facility</u>		
Residential Whole Loans ⁽¹⁾	10%	10%
<u>Commercial Whole Loan Facility</u>		
Commercial Loans ⁽²⁾	22%	32%

(1) The haircut is based on 10% of the outstanding principal amount of the Residential Whole Loans.

(2) Each Commercial Loans is financed separately under this facility and the haircuts are dependent on the type of collateral.

Residential Whole Loan Facility

The facility was extended on November 9, 2022 and matures on October 25, 2023. It bears interest at a rate of SOFR plus 2.25%, with a SOFR floor of 0.25%. We finance our Non-QM Residential Whole Loans held in RMI 2015 Trust under this facility. As of December 31, 2022, we had outstanding borrowings of \$3.6 million. The borrowing is secured by Non-QM Residential Whole Loans with a fair value of \$3.2 million and one REO property with a carrying value of \$2.3 million as of December 31, 2022.

Non-Agency CMBS and Non-Agency RMBS Facility

The facility was extended on May 2, 2022 and matures on May 2, 2023. It bears interest at a rate of SOFR plus 2.00%. As of December 31, 2022, the outstanding balance under this facility was \$91.1 million. The borrowing is secured by investments with a fair market value of \$129.9 million as of December 31, 2022.

Commercial Whole Loan Facility

The facility was extended on November 9, 2022 and matures on November 3, 2023. It bears interest at a rate of SOFR plus 2.25%. As of December 31, 2022, the outstanding balance under this facility was \$48.0 million. The borrowing is secured by the performing commercial loans that are held in CRE LLC, with an estimated fair market value of \$66.9 million as of December 31, 2022.

Convertible Senior Unsecured Notes

For the year ended December 31, 2022, through a series of transactions summarized below, we reduced the our overall convertible senior unsecured notes outstanding by \$37.7 million. The following summarizes the transactions for the twelve months ended December 31, 2022.

- During the first quarter of 2022, we repurchased \$3.4 million aggregate principal amount of our convertible senior unsecured notes due 2022 (the “2022 Notes”) at a weighted average premium to par value of 0.8%.
- During the second quarter of 2022, we repurchased \$7.2 million aggregate principal amount of the 2022 Notes at a weighted average premium to par value of 0.6%.
- During the third quarter of 2022, we repurchased \$1.0 million aggregate principal amount of the 2022 Notes at par value.
- On October 3, 2022, the 2022 Notes matured. We repaid the remaining \$26.0 million aggregate principal amount at par value.

Outstanding Borrowings

Repurchase Agreements

At December 31, 2022, we had outstanding borrowings under six of our master repurchase agreements. The following table summarizes certain characteristics of our repurchase agreements at December 31, 2022 (dollars in thousands):

Securities Pledged	Repurchase Agreement Borrowings	Weighted Average Interest Rate on Borrowings Outstanding at end of period	Weighted Average Remaining Maturity (days)
Short Term Borrowings:			
Agency RMBS	\$ 293	4.78%	32
Non-Agency RMBS ⁽¹⁾	48,237	7.50%	26
Other securities	1,776	7.09%	17
Total short term borrowings	50,306	7.47%	26
Long Term Borrowings:			
<i>Non-Agency CMBS and Non-Agency RMBS Facility</i>			
Non-Agency CMBS ⁽¹⁾	55,154	6.30%	122
Non-Agency RMBS	19,129	6.30%	122
Other Securities	16,863	6.30%	122
Subtotal	91,146	6.30%	122
<i>Residential Whole Loan Facility</i>			
Residential Whole Loans ⁽²⁾	3,633	6.66%	298
<i>Commercial Whole Loan Facility</i>			
Commercial Loans	48,032	6.13%	307
Total long term borrowings	142,811	6.25%	189
Repurchase agreement borrowings	\$ 193,117	6.57%	146
Less unamortized debt issuance costs	—	N/A	N/A
Repurchase agreement borrowings, net.....	\$ 193,117	6.57%	146

- (1) Includes repurchase agreement borrowings on securities eliminated upon VIE consolidation.
(2) Repurchase agreement borrowings on loans owned are through trust certificates. The trust certificates are eliminated in consolidation.

At December 31, 2022, we had outstanding repurchase agreement borrowings with the following counterparties:

(dollars in thousands) Repurchase Agreement Counterparties	Amount Outstanding	Percent of Total Amount Outstanding	Investments Held as Collateral	Counterparty Rating ⁽¹⁾
Credit Suisse AG, Cayman Islands Branch ⁽²⁾	\$ 99,902	51.7%	\$ 150,897	A-
Citigroup Global Markets Inc.	91,146	47.2%	129,932	A+
Credit Suisse Securities (USA) LLC	1,776	0.9%	4,938	A-
All other counterparties ⁽³⁾	293	0.2%	249	
Total	\$ 193,117	100.0%	\$ 286,016	

- (1) The counterparty ratings presented above are the long-term issuer credit ratings as rated at December 31, 2022 by S&P.
(2) Includes master repurchase agreements in which the buyer includes Alpine Securitization LTD., a Credit Suisse sponsored asset-backed commercial paper conduit.
(3) Represents amount outstanding with one counterparty, which holds collateral valued less than 5% of our stockholders' equity as security for our obligations under the applicable repurchase agreements as of December 31, 2022.

The following table presents our average repurchase agreement borrowings, excluding unamortized debt issuance costs, by type of collateral pledged for the years ended December 31, 2022 and December 31, 2021 (dollars in thousands):

Collateral	Year ended December 31, 2022	Year ended December 31, 2021
Agency RMBS	\$ 451	\$ 1,182
Non-Agency RMBS ⁽¹⁾	62,876	46,140
Non-Agency CMBS ⁽¹⁾	59,735	78,476
Residential Whole Loans	136,439	125,746
Commercial Loans	64,121	118,660
Residential Bridge Loans	4,660	9,400
Membership interest	—	13,361
Other securities	29,254	26,489
Total	\$ 357,536	\$ 419,454
Maximum borrowings during the period ⁽²⁾	\$ 613,518	\$ 644,675

- (1) Includes repurchase agreement borrowings on securities eliminated upon VIE consolidation.
(2) Amount represents the maximum borrowings at month-end during each of the respective periods.

Repurchase Agreements Financial Metrics

Certain of our financing agreements provide the counterparty with the right to terminate the agreement and accelerate amounts due under the associated agreement if we do not maintain certain financial metrics. Although specific to each financing arrangement, typical financial metrics include minimum equity and liquidity requirements, leverage ratios, and performance triggers. In addition, some of the financing arrangements contain cross-default features, whereby default under an agreement with one lender simultaneously causes default under agreements with other lenders. We were in compliance with the terms of such financial tests as of December 31, 2022.

Securitized Debt

Arroyo Trust 2019-2

In May 2019, we completed a residential mortgage-backed securitization comprised of \$945.5 million of Non-QM residential whole loans. The Arroyo Mortgage Trust 2019-2 ("Arroyo Trust 2019"), a wholly owned subsidiary, issued \$919.0 million of mortgage-backed notes and we retained the non-offered securities in the securitization, which include the class B, Class A-IO-S and Class XS certificates. These non-offered securities were eliminated in consolidation. At December 31, 2022, Residential Whole Loans, with an outstanding principal balance of approximately \$243.3 million, serve as collateral for the Arroyo Trust's securitized debt.

The following table summarizes the consolidated Arroyo Trust's issued mortgage-backed notes at December 31, 2022 which is classified in "Securitized debt, net" in the Consolidated Balance Sheets (dollars in thousands):

Classes	Principal Balance	Coupon	Carrying Value	Contractual Maturity
Offered Notes:				
Class A-1	\$ 168,131	3.3%	\$ 168,131	4/25/2049
Class A-2	9,017	3.5%	9,017	4/25/2049
Class A-3	14,286	3.8%	14,286	4/25/2049
Class M-1	25,055	4.8%	25,055	4/25/2049
Subtotal	<u>\$ 216,489</u>		<u>\$ 216,489</u>	
Less: Unamortized deferred financing costs	N/A		2,604	
Total	<u>\$ 216,489</u>		<u>\$ 213,885</u>	

Arroyo Trust 2020-1

In June 2020, we completed a second residential mortgage-backed securitization. The Arroyo Trust 2020-1 ("Arroyo Trust 2020") issued \$341.7 million of mortgage-backed notes and we retained the non-offered securities in the securitization, which include the class B, Class A-IO-S and Class XS certificates. These non-offered securities were eliminated in consolidation. At December 31, 2022, Residential Whole Loans, with an outstanding principal balance of approximately \$140.5 million, serve as collateral for the Arroyo Trust 2020's securitized debt.

The following table summarizes the consolidated Arroyo Trust 2020's issued mortgage-backed notes at December 31, 2022 which is classified in "Securitized debt, net" in the Consolidated Balance Sheets (dollars in thousands):

Classes	Principal Balance	Coupon	Carrying Value	Contractual Maturity
Offered Notes:				
Class A-1A	\$ 74,425	1.7%	\$ 74,425	3/25/2055
Class A-1B	8,831	2.1%	8,831	3/25/2055
Class A-2	13,518	2.9%	13,518	3/25/2055
Class A-3	17,963	3.3%	17,963	3/25/2055
Class M-1	11,739	4.3%	11,739	3/25/2055
Subtotal	<u>\$ 126,476</u>		<u>\$ 126,476</u>	
Less: Unamortized deferred financing costs	N/A		1,542	
Total	<u>\$ 126,476</u>		<u>\$ 124,934</u>	

Arroyo Trust 2022-1

In February 2022, we completed a third residential mortgage-backed securitization. The Arroyo Trust 2022-1 ("Arroyo Trust 2022-1") issued \$398.9 million of mortgage-backed notes and we retained the non-offered securities in the securitization, which include the class B, Class A-IO-S and Class XS certificates. These non-offered securities were eliminated in consolidation. At December 31, 2022, Residential Whole Loans, with an outstanding principal balance of approximately \$394.7 million, serve as collateral for the Arroyo Trust 2022-1's securitized debt.

The following table summarizes the consolidated Arroyo Trust 2022-1's issued mortgage-backed notes at December 31, 2022 which is classified in "Securitized debt, net" in the Consolidated Balance Sheets (dollars in thousands):

Classes	Principal Balance	Coupon	Fair Value	Contractual Maturity
Offered Notes:				
Class A-1A	\$ 212,307	2.5%	\$ 194,438	12/25/2056
Class A-1B	82,942	3.3%	73,259	12/25/2056
Class A-2	21,168	3.6%	17,054	12/25/2056
Class A-3	28,079	3.7%	21,308	12/25/2056
Class M-1	17,928	3.7%	12,160	12/25/2056
Total	<u>\$ 362,424</u>		<u>\$ 318,219</u>	

Arroyo 2022-2

In July 2022, we completed a fourth residential mortgage-backed securitization. The Arroyo Trust 2022-2 ("Arroyo Trust 2022-2") issued \$351.9 million of mortgage-backed notes and we retained the non-offered securities in the securitization, which include the class B, Class A-IO-S and Class XS certificates. These non-offered securities were eliminated in consolidation. At December 31, 2022, Residential Whole Loans, with an outstanding principal balance of approximately \$385.0 million, serve as collateral for the Arroyo Trust 2022-2's securitized debt.

The following table summarizes the consolidated Arroyo Trust 2022-2's issued mortgage-backed notes at December 31, 2022 which is classified in "Securitized debt, net" in the Consolidated Balance Sheets (dollars in thousands):

Classes	Principal Balance	Coupon	Fair Value	Contractual Maturity
Offered Notes:				
Class A-1	\$ 267,533	5.0%	\$ 260,217	7/25/2057
Class A-2	22,773	5.0%	21,983	7/25/2057
Class A-3	27,749	5.0%	26,619	7/25/2057
Class M-1	17,694	5.0%	15,216	7/25/2057
Total	<u>\$ 335,749</u>		<u>\$ 324,035</u>	

Commercial Mortgage-Backed Notes

We hold a controlling financial variable interest in CSMC USA and were required to consolidate the CMBS VIE. Refer to Note 7, "Financings" to the consolidated financial statements contained in this Annual Report on Form 10-K for details. The following table summarizes the consolidated 2014 CSMC USA's commercial mortgage pass-through certificates at December 31, 2022 which is classified in "Securitized debt, net" in the Consolidated Balance Sheets (dollars in thousands):

Classes	Principal Balance	Coupon	Fair Value	Contractual Maturity
Class A-1	\$ 120,391	3.3%	\$ 108,591	9/11/2025
Class A-2	531,700	4.0%	477,678	9/11/2025
Class B	136,400	4.2%	115,782	9/11/2025
Class C	94,500	4.3%	76,304	9/11/2025
Class D	153,950	4.4%	113,229	9/11/2025
Class E	180,150	4.4%	99,858	9/11/2025
Class F	153,600	4.4%	77,242	9/11/2025
Class X-1 ⁽¹⁾	n/a	0.7%	7,430	9/11/2025
Class X-2 ⁽¹⁾	n/a	0.2%	1,497	9/11/2025
Total	<u>\$ 1,370,691</u>		<u>\$ 1,077,611</u>	

(1) Class X-1 and Class X-2 are interest-only classes with notional balances of \$652.1 million and \$733.5 million as of December 31, 2022, respectively.

The above table does not reflect the portion of the class F bond held by us because the bond is eliminated in consolidation. Our ownership interest in the class F bond represents a controlling financial interest, which resulted in consolidation of the trust. The class F bond had a fair market value of \$7.5 million at December 31, 2022, and our exposure to loss is limited to our ownership interest in this bond.

Convertible Senior Unsecured Notes

2024 Notes

In September 2021, the Company issued \$86.3 million in aggregate principal of convertible senior unsecured notes due 2024 (the "2024 Notes") for net proceeds of \$83.3 million. Interest on the 2024 Notes is paid semiannually. The 2024 Notes are convertible into, at the Company's election, cash, shares of the Company's common stock, or a combination of both, subject to the satisfaction of certain conditions and during specified periods. The conversion rate is subject to adjustment upon the occurrence of certain specified events and the holders may require the Company to repurchase all or any portion of their notes for cash equal to 100% of the principal amount of the 2024 Notes, plus accrued and unpaid interest, if the Company undergoes a fundamental change as specified in the supplemental indenture for the 2024 Notes. The post reverse stock split conversion rate is 33.7952 shares of common stock per \$1,000 principal amount of notes and represented a conversion price of \$29.59 per share of common stock. The 2024 Notes mature on September 15, 2024, unless earlier converted, redeemed, or repurchased by the holders pursuant to their terms, and are not redeemable by the Company except during the final three months prior to maturity. To the extent we issue shares of our common stock upon conversion of the 2024 Notes, the conversion of some, or all of our 2024 Notes, will dilute the ownership interests of existing stockholders.

Recourse and Non-Recourse Financing

We utilize both recourse and non-recourse debt to finance our portfolio. Our recourse debt included our short and long-term repurchase agreement financings and our convertible senior unsecured notes. At December 31, 2022, our total non-recourse financing is comprised of \$981.1 million of securitized debt issued in connection with our four Residential Whole Loan securitizations and \$1.1 billion of securitized debt from owning a Non-Agency CMBS bond with a fair value of \$7.5 million that was deemed a controlling financial variable interest in CSMC USA which required us to consolidate the CMBS VIE.

(dollars in thousands)	December 31, 2022	December 31, 2021
Recourse and non-recourse financing	\$ 2,335,323	\$ 2,599,845
Non-recourse financing		
Arroyo 2019-2	213,885	337,571
Arroyo 2020-1	124,934	181,547
Arroyo 2022-1	318,219	—
Arroyo 2022-2	324,035	—
CMSC USA	1,077,611	1,344,370
Total recourse financing	<u>\$ 276,639</u>	<u>\$ 736,357</u>
Stockholders' equity	\$ 94,804	\$ 193,109
Recourse leverage	<u>2.9x</u>	<u>3.8x</u>

Hedging Activity

The following tables summarize the hedging activity during the twelve months ended December 31, 2022 (dollars in thousands):

Derivative Instrument	Notional Amount at December 31, 2021	Acquisitions	Settlements, Terminations or Expirations	Notional Amount at December 31, 2022
Fixed pay interest rate swaps	\$ 22,000	\$ 333,300	\$ (197,300)	\$ 158,000
Interest rate swaptions	—	560,000	(560,000)	—
Credit default swaps	6,170	—	(6,170)	—
TBA securities - long positions	—	600,000	(600,000)	—
TBA securities - short positions	—	600,000	(600,000)	—
Total derivative instruments	<u>\$ 28,170</u>	<u>\$ 2,093,300</u>	<u>\$ (1,963,470)</u>	<u>\$ 158,000</u>

Derivative Instrument	Fair Value at December 31, 2021	Acquisitions	Settlements, Terminations or Expirations	Realized Gains/ Losses	Mark-to- market	Fair Value at December 31, 2022
Fixed pay interest rate swaps	\$ (38)	\$ —	\$ (13,764)	\$ 10,394	\$ 3,348	\$ (60)
Interest rate swaptions	—	473	(312)	(161)	—	—
Credit default swaps	(459)	—	347	(281)	393	—
TBA securities	—	—	(2,051)	2,051	—	—
Total derivative instruments	<u>\$ (497)</u>	<u>\$ 473</u>	<u>\$ (15,780)</u>	<u>\$ 12,003</u>	<u>\$ 3,741</u>	<u>\$ (60)</u>

Capital Markets Activity

The following is a summary of activity for the year ended December 31, 2022:

Stock Repurchase

On December 21, 2021, our Board of Directors reauthorized the repurchase program of up to 3,000,000 shares of our common stock through December 31, 2023. During the year ended December 31, 2022, the Company did not repurchase any shares under the stock repurchase program.

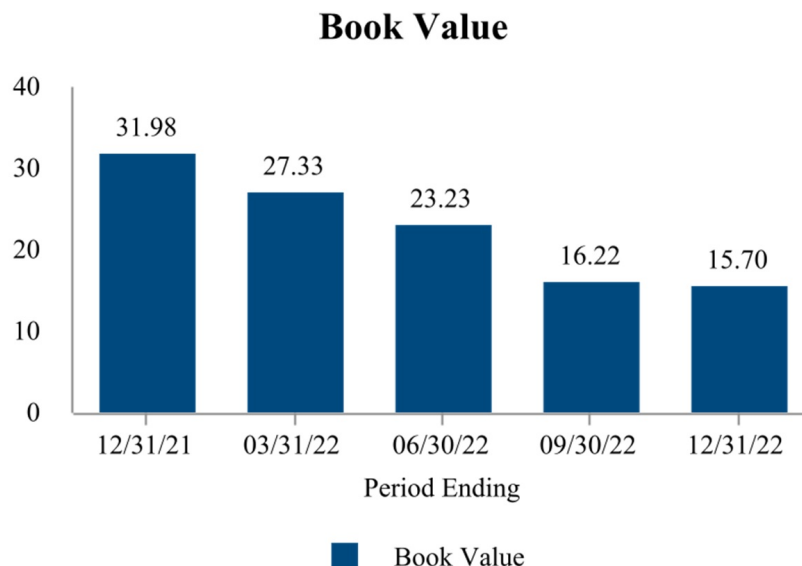
However, management's overall goals include growing the Company's equity base to help reduce the Company's expense ratio and expand capital for investment, but from time to time when shares are trading at a significant discount repurchasing shares can generate value for our shareholders. The timing, manner, price and amount of any future repurchases will be determined by the Company in its discretion and will be subject to economic and market conditions, stock price, applicable legal requirements and other factors.

Dividends

During the twelve months ended December 31, 2022, we declared dividends totaling \$1.60 per share generating a dividend yield of approximately 17.6% based on the stock closing price of \$9.11 on December 30, 2022

Book Value

The following chart reflects our book value per common share basic and diluted shares over five consecutive quarters:



We continue to implement measures to improve our balance sheet by increasing liquidity, reducing leverage, and seeking alternative financing arrangements to preserve long-term shareholder value. The decrease in book value to \$15.70 at December 31, 2022 when compared to our September 30, 2022 book value of \$16.22 was primarily driven by spread widening across our holdings, but mainly from our residential whole loans due to their relative size in the overall portfolio.

Review of Strategic Alternatives

On August 4, 2022, we announced that our Board of Directors had authorized a review of strategic alternatives for the Company aimed at enhancing shareholder value, which may include a sale or merger of the Company. JMP Securities, A Citizens Company, was retained as exclusive financial advisor to the Company. No assurance can be given that the review being undertaken will result in a sale, merger, or other transaction sale or other business combination involving the Company, and we have not set a timetable for completion of the review process. As previously announced, we do not intend to make any further statements regarding this process unless and until a definitive agreement for a transaction has been reached, or until the process of exploring strategic alternatives has ended.

Results of Operations

Comparison of the year ended December 31, 2022 to the year ended December 31, 2021

General

In 2022, we continued to make progress towards strengthening our balance sheet and improving liquidity. During the year ended December 31, 2022, through a series of transactions, we repaid in full our convertible senior unsecured notes outstanding, which matured on October 1, 2022. We also amended and extended two key financing facilities, our Residential Whole Loan Facility and our Non-Agency RMBS and Non-Agency CMBS Facility, resulting in improved advance rates and lowered interest rates. These facilities have limited mark-to-market provisions (See Note 7, “Financings” to the consolidated financial statements contained in this Annual Report on Form 10-K for additional details.).

For the year ended December 31, 2022, we generated a net loss of \$89.1 million or \$14.77 per basic and diluted weighted common share, compared to a net loss of \$49.0 million or \$8.07 per basic and diluted weighted common share for the year ended December 31, 2021. This was largely due to a decrease in the value of our securitized commercial loan, consolidated in accordance with VIE guidance, resulting in an unrealized loss of \$297.3 million, as well as spread widening with respect to the pricing of residential whole loans throughout 2022. This decline in fair value of residential whole loans of \$108.7 million was partially offset by \$3.5 million of unrealized gains on derivatives due to our hedging activity. We also reduced the value of CRE 3, during the third quarter of 2022 by \$18.1 million, as senior lenders consummated a foreclosure on the equity interest in the property. The loan was sold in 2023 for a sales price equal to its fair value at December 31, 2022 (See Note 6, “Commercial Loans” to the consolidated financial statements contained in this Annual Report on Form 10-K for additional details.).

In contrast, for the year ended December 31, 2021, we recognized a net loss of \$49.0 million or \$8.07 per basic and diluted weighted common share, which was primarily attributable to a decline in fair value of our commercial real estate loans.

The following tables set forth certain information regarding our net interest income on our investment portfolio for the years ended December 31, 2022 and December 31, 2021 (dollars in thousands):

Year ended December 31, 2022	Average Amortized Cost of Assets	Total Interest Income	Yield on Average Assets
Investments			
Agency RMBS	\$ 59	\$ 12	20.34%
Non-Agency RMBS	41,814	2,108	5.04%
Non-Agency CMBS	133,266	9,744	7.31%
Residential Whole Loans.....	1,176,706	48,269	4.10%
Residential Bridge Loans	5,364	1,223	22.80%
Commercial Loans	188,016	5,535	2.94%
Securitized commercial loan	1,274,894	88,171	6.92%
Other securities.....	44,677	3,657	8.19%
Total investments	\$ 2,864,796	\$ 158,719	5.54%
	Average Carrying Value	Total Interest Expense	Average Cost of Funds ⁽¹⁾
Borrowings			
Repurchase agreements	\$ 357,536	\$ 12,176	3.41%
Convertible senior unsecured notes, net	106,099	9,364	8.83%
Securitized debt	2,176,270	116,192	5.34%
Total borrowings	\$ 2,639,905	\$ 137,732	5.22%
Net interest income and net interest margin ⁽²⁾		\$ 20,987	0.73%
	Average Amortized Cost of Assets	Total Interest Income	Yield on Average Assets
Year ended December 31, 2021			
Investments			
Agency RMBS	\$ 89	\$ 17	19.10%
Non-Agency RMBS	29,128	1,457	5.00%
Non-Agency CMBS	198,214	16,409	8.28%
Residential Whole Loans.....	917,960	35,092	3.82%
Residential Bridge Loans	10,043	1,099	10.94%
Commercial Loans	270,982	12,537	4.63%
Securitized commercial loan	1,427,347	94,349	6.61%
Other securities.....	49,330	3,111	6.31%
Total investments	\$ 2,903,093	\$ 164,071	5.65%
	Average Carrying Value	Total Interest Expense	Average Cost of Funds ⁽¹⁾
Borrowings			
Repurchase agreements	\$ 419,455	\$ 14,517	3.46%
Convertible senior unsecured notes, net	150,961	12,805	8.48%
Securitized debt	2,078,156	109,588	5.27%
Total borrowings	\$ 2,648,572	\$ 136,910	5.17%
Net interest income and net interest margin ⁽²⁾		\$ 27,161	0.94%

(1) Average cost of funds does not include the interest expense related to our derivatives. In accordance with GAAP, such costs are included in "Gain (loss) on derivative instruments, net" in the Consolidated Statements of Operations.

(2) Since we do not apply hedge accounting, our net interest margin in this table does not reflect the benefit/cost of our interest rate swaps. See Non-GAAP Financial Measure section for net investment income table that includes the benefit/cost from our interest rate swaps.

Interest Income

For the years ended December 31, 2022 and December 31, 2021, we earned interest income on our investments of approximately \$158.7 million and \$164.1 million, respectively. The decrease of approximately \$5.4 million was mainly due to a smaller investment portfolio from 2022 payoffs of \$216.1 million in our Residential Whole Loans portfolio and the sale of \$56.4 million in mortgage-backed securities.

Interest Expense

Interest expense increased by \$822 thousand for the year ended December 31, 2022, compared to December 31, 2021, mainly a result of an increase in interest expense paid on securitized debt with respect to our residential whole loans, as two trusts, Arroyo 2022-1 and Arroyo 2022-2, were securitized in 2022. This was partially offset by a decrease in interest expense on our Convertible Senior Notes as the 2022 Notes were paid off throughout the year, and eventually paid in full in October 2022, as well as a decrease in interest expense incurred on securitized debt with respect to commercial loans as these loans are not our Manager's investment focus going forward.

Other income (loss), net

Realized gain (loss), net

Realized gain (loss), net represents the net gain (loss) on sales or settlements from our investment portfolio and debt. The following table presents the realized gains (losses) for each of the years ended December 31, 2022 and December 31, 2021 (dollars in thousands):

	Year ended December 31, 2022				Year ended December 31, 2021			
	Proceeds (Payments)	Gross Gains	Gross Losses	Net Gain (Loss)	Proceeds (Payments)	Gross Gains	Gross Losses	Net Gain (Loss)
Non-Agency RMBS.....	\$ 31,790	\$ 255	\$ (2,652)	\$ (2,397)	\$ —	\$ —	\$ —	\$ —
Non-Agency CMBS.....	10,152	—	(43,934)	(43,934)	27,488	—	(9,266)	(9,266)
Other securities	14,485	—	(2,252)	(2,252)	—	—	—	—
Residential Whole Loans.....	11,735	43	(76)	(33)	—	—	—	—
Residential Bridge Loans ⁽¹⁾	—	—	—	—	—	20	(205)	(185)
Loans transferred to REO ⁽²⁾	2,255	—	(69)	(69)	752	15	(36)	(21)
Disposition of REO ⁽³⁾	55,573	12,198	(232)	11,966	738	54	—	54
Convertible senior unsecured notes ⁽⁴⁾	(37,554)	—	50	50	(136,754)	405	(1,914)	(1,509)
Total	\$ 88,436	\$ 12,496	\$ (49,165)	\$ (36,669)	\$ (107,776)	\$ 494	\$ (11,421)	\$ (10,927)

(1) Realized gains/losses recognized on the final settlement of the loans.

(2) Realized gains/losses recognized on the transfer of Residential Whole Loans and Residential Bridge Loans to REO. Proceeds represent the fair value less estimated selling costs of the real estate on the date of transfer.

(3) Realized gains/losses recognized in connection with the sale of the hotel REO.

(4) Realized gains/losses recognized on the extinguishment of the 2022 Notes. See Note 7, "Financings" to the consolidated financial statements contained in this Annual Report on Form 10-K

Unrealized gain (loss), net

Our investments, and securitized debt, for which we have elected the fair value option are recorded at fair value with the periodic changes in fair value being recorded in earnings. The change in unrealized gain (loss) is directly attributable to changes in market pricing on the underlying investments and securitized debt during the period.

We recognized an unrealized loss of \$63.9 million for the twelve months ended December 31, 2022, mainly driven by unfavorable marks on the securitized commercial loan and residential whole loans.

We recognized an unrealized loss of \$46.4 million for the twelve months ended December 31, 2021, mainly driven by the non-performing CRE 3 junior mezzanine loan and our Non-Agency CMBS investments. During the twelve months ended December 31, 2021, the fair value of the commercial mezzanine loan declined significantly, and we recognized an unrealized loss of \$51.2 million. Generally, we saw a recovery in asset prices across our residential investments.

The following table presents the net unrealized gains (losses) we recorded on our investments and securitized debt (dollars in thousands):

	Year ended December 31, 2022	Year ended December 31, 2021
Agency RMBS	\$ (62)	\$ —
Non-Agency RMBS	(9,196)	3,543
Non-Agency CMBS	40,102	(13,322)
Residential Whole Loans	(108,207)	2,850
Residential Bridge Loans	91	928
Commercial loans.....	(19,977)	(46,813)
Securitized commercial loan	(297,343)	79,972
Other securities	(7,923)	4,468
Securitized debt.....	338,641	(78,017)
Total	<u>\$ (63,874)</u>	<u>\$ (46,391)</u>

Gain (loss) on derivatives, net

As of December 31, 2022, we had interest rate swaps with a notional amount of \$158.0 million and no forward starting swaps. Our hedging strategy is designed to mitigate our exposure to interest rate volatility.

The following table presents the components of gain (loss) on derivatives for the years ended December 31, 2022 and December 31, 2021 (dollars in thousands):

Description	Realized Gain (Loss), net		Mark-to-market	Return (Recovery) of Basis	Contractual interest income (expense), net ⁽¹⁾	Total
	Other Settlements/ Expirations	Variation Margin Settlement				
Year ended December 31, 2022						
Interest rate swaps	\$ (3,371)	\$ 13,765	\$ 3,348	\$ —	\$ 628	\$ 14,370
Interest rate swaptions	(161)	—	—	—	—	(161)
Agency and Non-Agency Interest-Only Strips - accounted for as derivatives.....	—	—	(242)	(102)	151	(193)
Credit default swaps	(242)	—	393	—	—	151
TBAs	2,051	—	—	—	—	2,051
Total	<u>\$ (1,723)</u>	<u>\$ 13,765</u>	<u>\$ 3,499</u>	<u>\$ (102)</u>	<u>\$ 779</u>	<u>\$ 16,218</u>
Year ended December 31, 2021						
Interest rate swaps	\$ —	\$ 490	\$ (38)	\$ —	\$ 109	\$ 561
Agency and Non-Agency Interest-Only Strips - accounted for as derivatives.....	—	—	(206)	(300)	394	(112)
Credit default swaps	64	—	36	—	—	100
Total	<u>\$ 64</u>	<u>\$ 490</u>	<u>\$ (208)</u>	<u>\$ (300)</u>	<u>\$ 503</u>	<u>\$ 549</u>

(1) Contractual interest income (expense), net on derivative instruments includes interest settlement paid or received.

Other, net

For the years ended December 31, 2022 and December 31, 2021, “Other, net” consisted of expense of \$147 thousand and income of \$490 thousand, respectively. The balance is mainly comprised of interest on cash balances, miscellaneous net interest income (expense) on cash collateral for our repurchase agreements and derivatives and miscellaneous fees collected on residential mortgage loans.

Expenses

Management Fee

We incurred management fee expense of approximately \$3.9 million and \$5.9 million for the years ended December 31, 2022 and December 31, 2021, respectively. Pursuant to the terms of the Management Agreement, our Manager is paid a management fee equal to 1.5% per annum of our stockholders’ equity (as defined in the Management Agreement), calculated and payable (in cash) quarterly in arrears. The decrease was mainly attributable to our Manager voluntarily waiving 25% of its management fee solely for the duration of the calendar year 2022 in order to support our earnings potential and our transition to a residential focused investment portfolio. Future waivers, if any, are at the Manager’s discretion.

The management fees, expense reimbursements and the relationship between our Manager and us are discussed further in Note 10, “Related Party Transactions” to the consolidated financial statements contained in this Annual Report on Form 10-K.

Other Operating Expenses

We incurred other operating expenses of approximately \$1.4 million and \$1.5 million for the years ended December 31, 2022 and December 31, 2021, respectively. Other operating cost is comprised of derivative transaction costs, custody, acquisition transaction costs and asset management/loan servicing fees. The decrease was primarily a result of decreased trustee and servicing fees incurred on our commercial loan portfolio as we focus investment efforts on our residential whole loan portfolio, partially offset by an increase in trustee fees related to the two securitizations transacted during 2022.

Transaction Costs

We incurred transaction costs of \$6.3 million and \$3.2 million for the years ended December 31, 2022 and December 31, 2021, respectively, and costs incurred in connection with our strategic alternative review of \$639 thousand. The increase in transaction cost is primarily associated with the Arroyo Trust 2022-1 and Arroyo Trust 2022-2 securitizations that were completed in February 2022 and July 2022, respectively. Transaction costs incurred for the year ended December 31, 2021 were associated with the foreclosure of one of our commercial loans.

General and Administrative Expenses

General and administrative expenses for the years ended December 31, 2022 and December 31, 2021 were \$10.2 million and \$10.0 million, respectively. The increase was mainly attributable to an increase in professional fees offset by a decrease in compensation expense due to employee turnover during 2022.

Comparison of the year ended December 31, 2021 to the year ended December 31, 2020

General

Due to the continued uncertainty surrounding the COVID -19 pandemic our results of operations continued to be impacted and for the years ended December 31, 2021 and December 31, 2020 may not be comparable.

In 2021, we continued to make progress towards strengthening our balance sheet and improving liquidity. During the year ended December 31, 2021, through a series of transactions, we reduced the aggregate principal amount of our convertible senior unsecured notes outstanding by \$51.1 million and extended the maturity to 2024 for \$86.3 million of our convertible senior unsecured debt through the issuance of the 2024 Notes. We also amended and extended two key financing facilities, our Residential Whole Loan Facility and our Non-Agency RMBS and Non-Agency CMBS Facility, resulting in improved advance rates and lowered interest rates. These facilities have limited mark to market provisions (See Note 7, “Financings” to the consolidated financial statements contained in this Annual Report on Form 10-K for additional details.). For the year ended December 31, 2021 we did not receive a margin call on either of these facilities.

For the year ended December 31, 2021, we generated a net loss of \$49.0 million or \$8.07 per basic and diluted weighted common share, compared to a net loss of \$328.4 million or \$57.20 per basic and diluted weighted common share for the year ended December 31, 2020. Although the residential credit markets improved in the twelve months ended December 31, 2021, our commercial real estate investments especially in the retail and hospitality sectors are taking longer to recover, which impacted valuations and was a key driver of the net loss for the period. Our Non-Agency CMBS and Commercial Loan investments declined in fair value by approximately \$60.1 million and further losses are possible. However, during the third quarter of 2021, certain of our commercial investments benefited from improvements in the commercial mortgage markets resulting in \$157.2 million in payoffs from three commercial loans, a Non-Agency CMBS bond and a risk retention bond. With our new focus of capital allocation in residential real estate-related investments, in the second half of 2021, we deployed capital to acquire \$417.8 million in Non-QM loans and in December 2021, we strategically sold three Non-Agency CMBS investments for net proceeds of \$27.5 million.

The following tables set forth certain information regarding our net interest income on our investment portfolio for the years ended December 31, 2021 and December 31, 2020 (dollars in thousands):

Year ended December 31, 2021	Average Amortized Cost of Assets	Total Interest Income	Yield on Average Assets
Investments			
Agency RMBS.....	89	17	19.10%
Non-Agency RMBS.....	29,128	1,457	5.00%
Non-Agency CMBS.....	198,214	16,409	8.28%
Residential Whole Loans.....	917,960	35,092	3.82%
Residential Bridge Loans.....	10,043	1,099	10.94%
Commercial Loans.....	270,982	12,537	4.63%
Securitized commercial loans.....	1,427,347	94,349	6.61%
Other securities.....	49,330	3,111	6.31%
Total.....	\$ 2,903,093	\$ 164,071	5.65%

	<u>Average Carrying Value</u>	<u>Total Interest Expense</u>	<u>Average Cost of Funds⁽¹⁾</u>
Borrowings			
Repurchase agreements	\$ 419,455	\$ 14,517	3.46%
Convertible senior unsecured notes, net.....	150,961	12,805	8.48%
Securitized debt	<u>2,078,156</u>	<u>109,588</u>	<u>5.27%</u>
Total borrowings.....	<u>\$ 2,648,572</u>	<u>\$ 136,910</u>	<u>5.17%</u>
Net interest income and net interest margin ⁽²⁾		<u>\$ 27,161</u>	<u>0.94%</u>

Year ended December 31, 2020	<u>Average Amortized Cost of Assets</u>	<u>Total Interest Income</u>	<u>Yield on Average Assets</u>
Investments			
Agency CMBS.....	\$ 342,673	\$ 10,700	3.12%
Agency RMBS.....	58,491	1,988	3.40%
Non-Agency RMBS.....	32,905	1,539	4.68%
Non-Agency CMBS.....	262,372	21,798	8.31%
Residential Whole Loans.....	1,223,043	54,359	4.44%
Residential Bridge Loans.....	26,354	1,756	6.66%
Commercial Whole-Loans.....	337,485	23,194	6.87%
Securitized commercial loan	1,093,487	59,212	5.41%
Other securities	53,753	3,482	6.48%
Total	<u>\$ 3,430,563</u>	<u>\$ 178,028</u>	<u>5.19%</u>

	<u>Average Carrying Value</u>	<u>Total Interest Expense</u>	<u>Average Cost of Funds⁽¹⁾</u>
Borrowings			
Repurchase agreements	\$ 1,108,838	\$ 35,243	3.18%
Convertible senior unsecured notes, net.....	193,516	16,252	8.40%
Securitized debt	<u>1,864,964</u>	<u>81,096</u>	<u>4.35%</u>
Total borrowings.....	<u>\$ 3,167,318</u>	<u>\$ 132,591</u>	<u>4.19%</u>
Net interest income and net interest margin ⁽²⁾		<u>\$ 45,437</u>	<u>1.32%</u>

(1) Average cost of funds does not include the interest expense related to our derivatives. In accordance with GAAP, such costs are included in “Gain (loss) on derivative instruments, net” in the Consolidated Statements of Operations.

(2) Since we do not apply hedge accounting, our net interest margin in this table does not reflect the benefit / cost of our interest rate swaps. See Non-GAAP Financial Measure section for net investment income table that includes the benefit / cost from our interest rate swaps.

Interest Income

For the years ended December 31, 2021 and December 31, 2020, we earned interest income on our investments of approximately \$164.1 million and \$178.0 million, respectively. The decrease of approximately \$14.0 million was mainly due to a smaller investment portfolio from 2021 payoffs of \$406.7 million and \$157.2 million in our Residential Whole Loans and commercial investments, respectively, and our \$90.0 million commercial mezzanine loan becoming non-performing in May 2021. The consolidation of CSMC USA as of August 1, 2020 and the 2021 acquisition, in the latter part of 2021, of \$427.8 million, in Non-QM loans partially offset the decline in interest income.

Interest Expense

Interest expense increased by \$4.3 million for the year ended December 31, 2021, compared to December 31, 2020, mainly as a result of the consolidation of CSMC USA, which increased interest expense by \$48.2 million. However, interest expense on our recourse leverage declined by \$24.2 million from lower average borrowings attributable to a smaller investment portfolio, improved terms on our amended residential and securities financing facilities, and the repurchases of our 2022 Notes. Also, in 2021 interest expense declined by \$17.9 million related to our securitized debt from the payoff of RETL 2019 Trust and paydown in our residential mortgage-backed debt (Arroyo Trust 2019 and Arroyo Trust 2020).

Other income (loss)

Realized gain (loss) on investments, net

Realized gain (loss) represents the net gain (loss) on sales or settlements from our investment portfolio and debt. In December 2021, as part of our new investment focus on residential real estate-related investments we strategically sold three Non-Agency CMBS investments for net proceeds of \$27.5 million, realizing a loss of \$1.1 million. For the twelve months ended December 31, 2020, to improve liquidity, reduce our repurchase agreement borrowing and satisfy our margin calls, we sold \$2.4 billion in investments mainly in March and April 2020. These sales generated \$84.3 million in net realized gains.

The following table presents the sales and realized gains (loss) of our investments for the years ended December 31, 2021 and December 31, 2020 (dollars in thousands):

	Year ended December 31, 2021				Year ended December 31, 2020			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency CMBS.....	\$ —	\$ —	\$ —	\$ —	\$ 1,668,149	\$ 116,463	\$ (6,486)	\$ 109,977
Agency RMBS.....	—	—	—	—	400,948	12,552	(506)	12,046
Non-Agency RMBS ⁽¹⁾	—	—	—	—	12,658	—	(60)	(60)
Non-Agency CMBS ⁽⁴⁾	27,488	—	(9,266)	(9,266)	111,804	1	(23,624)	(23,623)
Other securities.....	—	—	—	—	35,957	113	(6,223)	(6,110)
Residential Whole Loans.....	—	—	—	—	144,259	—	(10,511)	(10,511)
Residential Bridge Loans ⁽¹⁾	—	20	(205)	(185)	—	8	(404)	(396)
Loans transferred to REO ⁽²⁾	752	15	(36)	(21)	419	126	(32)	94
Disposition of REO.....	738	54	—	54	1,892	18	(808)	(790)
Convertible senior unsecured notes ⁽³⁾	\$ (136,754)	\$ 405	\$ (1,914)	\$ (1,509)	\$ (21,975)	\$ 3,644	\$ —	\$ 3,644
Total.....	\$ (107,776)	\$ 494	\$ (11,421)	\$ (10,927)	\$ 2,354,111	\$ 132,925	\$ (48,654)	\$ 84,271

(1) Realized gains/losses recognized on the final settlement of the loans.

(2) Realized gains/losses recognized on the transfer of Residential Bridge Loans to REO. Proceeds represent the fair value less estimated selling costs of the real estate on the date of transfer.

(3) Realized gains/losses recognized on the extinguishment of the 2022 Notes. See Note 7, “Financings” to the consolidated financial statements contained in this Annual Report on Form 10-K for details.

(4) Realized losses of \$8.2 million were recognized on the permanent write down of Non-Agency CMBS investments for the year ended December 31, 2021.

Unrealized gain (loss), net

Our investments, and securitized debt, for which we have elected the fair value option are recorded at fair value with the periodic changes in fair value being recorded in earnings. The change in unrealized gain (loss) is directly attributable to changes in market pricing on the underlying investments and securitized debt during the period.

We recognized an unrealized loss of \$46.4 million for the twelve months ended December 31, 2021, mainly driven by the non-performing CRE 3 junior mezzanine loan and our Non-Agency CMBS investments. During the twelve months ended December 31, 2021 the fair value of the commercial mezzanine loan declined significantly, and we recognized an unrealized loss of \$51.2 million. Generally, we saw a recovery in asset prices across our residential investments.

We recognized an unrealized loss of \$221.4 million for the twelve months ended December 31, 2020, driven by the extreme lack of liquidity in mortgage markets combined with forced selling which led to swift and dramatic price declines in the first quarter of 2020. While we saw some price recovery of certain investments in the second quarter of 2020, the rally was not sufficient to significantly reduce the substantial unrealized loss from the dramatic price declines in the first quarter of 2020.

The following table presents the net unrealized gains (losses) we recorded on our investment and securitized debt (dollars in thousands):

	Year ended December 31, 2021	Year ended December 31, 2020
Agency CMBS.....	\$ —	\$ (61,033)
Agency RMBS.....	—	(9,131)
Non-Agency RMBS.....	3,543	(5,812)
Non-Agency CMBS.....	(13,322)	(50,841)
Residential Whole Loans.....	2,850	(22,891)
Residential Bridge Loans.....	928	(497)
Commercial Loans.....	(46,813)	(15,281)
Securitized commercial loans.....	79,972	(58,421)
Other securities.....	4,468	(6,938)
Securitized debt.....	(78,017)	9,458
Total.....	\$ (46,391)	\$ (221,387)

Gain (loss) on derivatives, net

As of December 31, 2021, we had interest rate swaps with a notional amount of \$22.0 million. Our hedging strategy is designed to mitigate our exposure to interest rate volatility.

In March 2020, we effectively terminated all of our fixed-pay interest rate swaps and variable-pay interest rate swaps to reduce hedging costs and associated margin volatility. The effects of the termination is reflected in the table below for the year ended December 31, 2020.

The following table presents the components of gain (loss) on derivatives for the year ended December 31, 2021 and December 31, 2020 (dollars in thousands):

Description	Realized Gain (Loss), net		Mark-to-market	Return (Recovery) of Basis	Contractual interest income (expense), net ⁽¹⁾	Total
	Other Settlements/ Expirations	Variation Margin Settlement				
Year ended December 31, 2021						
Interest rate swaps.....	\$ —	\$ 490	\$ (38)	\$ —	\$ 109	\$ 561
Agency and Non-Agency Interest-Only Strips - accounted for as derivatives	—	—	(206)	(300)	394	(112)
Credit default swaps	64	—	36	—	—	100
Total	<u>\$ 64</u>	<u>\$ 490</u>	<u>\$ (208)</u>	<u>\$ (300)</u>	<u>\$ 503</u>	<u>\$ 549</u>
Year ended December 31, 2020						
Interest rate swaps.....	\$ (262)	\$ (179,759)	\$ (2,515)	\$ 262	\$ (1,395)	\$ (183,669)
Interest rate swaptions	80	—	—	—	—	80
Agency and Non-Agency Interest-Only Strips - accounted for as derivatives	(940)	—	(532)	(1,096)	1,324	(1,244)
Credit default swaps	(9,534)	—	(1,834)	—	—	(11,368)
TBAs	(2,430)	—	928	—	—	(1,502)
Total	<u>\$ (13,086)</u>	<u>\$ (179,759)</u>	<u>\$ (3,953)</u>	<u>\$ (834)</u>	<u>\$ (71)</u>	<u>\$ (197,703)</u>

(1) Contractual interest income (expense), net on derivative instruments includes interest settlement paid or received.

Other, net

For the years ended December 31, 2021 and December 31, 2020, “Other, net” consisted of income of \$490 thousand and income of \$339 thousand, respectively. The balance is mainly comprised of interest on cash balances, miscellaneous net interest income (expense) on cash collateral for our repurchase agreements and derivatives and miscellaneous fees collected on residential mortgage loans.

Expenses

Management Fee Expense

We incurred management fee expense of approximately \$5.9 million and \$4.5 million for the years ended December 31, 2021 and December 31, 2020, respectively. Pursuant to the terms of the Management Agreement, our Manager is paid a management fee equal to 1.5% per annum of our stockholders’ equity (as defined in the Management Agreement), calculated and payable (in cash) quarterly in arrears. The increase was mainly attributable to our Manager’s waiver of the management fee from March 2020 to May 2020 to help address the impact of COVID-19 and the disruption in the mortgage markets. Future waivers are at the Manager’s discretion.

The management fees, expense reimbursements and the relationship between our Manager and us are discussed further in Note 10, “Related Party Transactions” to the consolidated financial statements contained in this Annual Report on Form 10-K.

Financing Fee

In the second quarter of 2020, in order to manage the severe market conditions and the resulting large margin demands from lenders and pressure on our liquidity, we entered into a longer term financing arrangement for our Residential Whole Loans, as we sought to reduce our exposure to short-term financings with daily mark to market exposure. Under this agreement, we were required to pay the counterparty a 30% premium recapture fee of all realized value on any Residential Whole Loans above such counterparty’s amortized basis upon the securitization or sale.

On June 29, 2020, we securitized approximately \$355.8 million of the Residential Whole Loans and paid down the facility by approximately \$339.4 million (see “Securitized Debt” below for additional details). As noted above, as part of the financing arrangements, we agreed to pay the lender a fee of 30% of all realized value on the Residential Whole Loans above the counterparty’s amortized basis upon securitization or sale. As a result of refinancing the Residential Whole Loans through a securitization, we accrued a premium recapture fee of approximately \$20.5 million, which was payable at the maturity of the facility. However, in connection with an amendment to this facility effective October 6, 2020, we paid \$12.0 million of the fee with the balance of \$8.5 million paid on November 5, 2021 when the facility was further amended and extended to November 2022. The amendment also eliminated the premium recapture fee for assets financed under the amended facility.

Other Operating Expenses

We incurred other operating expenses of approximately \$4.7 million and \$2.9 million for the years ended December 31, 2021 and December 31, 2020, respectively. Other operating cost is comprised of derivative transaction costs, custody, acquisition transaction costs and asset management/loan servicing fees. The increase was primarily a result of transaction, real estate and insurance costs recorded in the consolidated SPE that holds the foreclosed hotel REO. The increase was partially offset by an overall decrease in derivative transaction costs, acquisition transaction costs and asset management/loan servicing fees.

Transaction Costs

We incurred transaction costs of \$3.2 million and \$804 thousand for the year ended December 31, 2021 and December 31, 2020, respectively. The increase in transaction costs is primarily associated with the foreclosure of one of our commercial loans. Transaction costs incurred for the year ended December 31, 2020 were associated with the Arroyo Trust 2020-1 securitization that was completed in June 2020.

General and Administrative Expenses

General and administrative expenses for the years ended December 31, 2021 and December 31, 2020 were \$10.0 million and \$11.0 million, respectively. The decrease was mainly attributable to a decrease in the cost of our director and officer insurance.

Non-GAAP Financial Measures

We believe that our non-GAAP measures (described below), when considered with GAAP, provide supplemental information useful to investors in evaluating the results of our operations. Our presentations of such non-GAAP measures may not be comparable to similarly-titled measures of other companies, who may use different calculations. As a result, such non-GAAP measures should not be considered as substitutes for our GAAP net income, as measures of our financial performance or any measure of our liquidity under GAAP.

Distributable Earnings

Distributable Earnings is a non-GAAP financial measure that is used by us to approximate cash yield or income associated with our portfolio and is defined as GAAP net income (loss) as adjusted, excluding: (i) net realized gain (loss) on investments and termination of derivative contracts; (ii) net unrealized gain (loss) on investments and debt; (iii) net unrealized gain (loss) resulting from mark-to-market adjustments on derivative contracts; (iv) provision for income taxes; (v) non-cash stock-based compensation expense; (vi) non-cash amortization of the convertible senior unsecured notes discount; (vii) one-time charges such as acquisition costs, strategic review expenses and impairment on loans and (viii) one-time events pursuant to changes in GAAP and certain other non-cash charges after discussions between us, our Manager and our independent directors and after approval by a majority of our independent directors.

We utilize Distributable Earnings as a key metric to evaluate the effective yield of the portfolio. Distributable Earnings allows us to reflect the net investment income of our portfolio as adjusted to reflect the net interest rate swap interest expense. Distributable Earnings allows us to isolate the interest expense associated with our interest rate swaps in order to monitor and project our borrowing costs and interest rate spread. It is one metric of several used in determining the appropriate distributions to our shareholders.

Due to the significant amount of investment sales, resulting from the market volatility created by the COVID-19 pandemic, our Distributable Earnings for the years ended December 31, 2022, December 31, 2021, and December 31, 2020 are not comparable.

The table below reconciles Net Loss to Distributable Earnings for the years ended December 31, 2022, December 31, 2021 and December 31, 2020:

(dollars in thousands)	Year ended December 31, 2022	Year ended December 31, 2021	Year ended December 31, 2020
Net loss attributable to common stockholders and participating securities	\$ (89,079)	\$ (48,953)	\$ (328,354)
Income tax provision.....	171	99	396
Net loss before income taxes.....	(88,908)	(48,854)	(327,958)
Adjustments:			
<i>Investments:</i>			
Net unrealized loss on investments and securitized debt	63,874	46,391	221,387
Net realized (gain) loss on investments.....	40,204	9,418	(80,627)
One-time transaction costs	6,424	2,415	21,232
<i>Derivative Instruments:</i>			
Net realized (gain) loss on derivatives	(12,003)	(490)	193,155
Net unrealized (gain) loss on derivatives	(3,499)	208	3,953
<i>Other:</i>			
Realized (gain) loss on extinguishment of convertible senior unsecured notes.....	(50)	1,509	(3,644)
Amortization of discount on convertible senior unsecured notes.....	820	944	1,097
Other non-cash adjustments	—	977	3,304
Non-cash stock-based compensation expense.....	435	618	699
Total adjustments	96,205	61,990	360,556
Distributable Earnings (non-GAAP).....	\$ 7,297	\$ 13,136	\$ 32,598

Alternatively, our Distributable Earnings can also be derived as presented in the table below by starting with adjusted net interest income, which includes interest income on Interest-Only Strips accounted for as derivatives and other derivatives, and net interest expense incurred on interest rate swaps and foreign currency swaps and forwards (a non-GAAP financial measure) subtracting total expenses, adding non-cash stock based compensation, adding one-time transaction costs, adding amortization of discount on convertible senior notes, and adding interest income on cash balances and other income (loss), net.

(dollars in thousands)	Year ended December 31, 2022	Year ended December 31, 2021	Year ended December 31, 2020
Net interest income	\$ 20,987	\$ 27,161	\$ 45,437
Interest income from IOs and IIOs accounted for as derivatives	49	94	228
Net interest income (expense) from interest rate swaps	628	109	(1,133)
Adjusted net interest income	21,664	27,364	44,532
Total expenses.....	(21,810)	(20,648)	(38,907)
Other non-cash adjustments	—	977	3,304
Non-cash stock-based compensation.....	435	618	699
One-time transaction costs	6,424	2,415	21,232
Amortization of discount on convertible unsecured senior notes.....	820	944	1,097
Interest income on cash balances and other income (loss), net.....	(108)	554	649
Income (loss) attributable to non-controlling interest	(128)	912	(8)
Distributable Earnings (non-GAAP).....	\$ 7,297	\$ 13,136	\$ 32,598

Reconciliation of GAAP Book Value to non-GAAP Economic Book Value

“Economic Book Value” is a non-GAAP financial measure of our financial position on an unconsolidated basis. We own certain securities that represent a controlling variable interest, which under GAAP requires consolidation; however, our economic exposure to these variable interests is limited to the fair value of the individual investments. Economic book value is calculated by taking the GAAP book value and 1) adding the fair value of the retained interest or acquired security of the VIEs held by us and 2) removing the asset and liabilities associated with each of consolidated trusts (CSMC USA, Arroyo 2019-2, Arroyo 2020-1, Arroyo 2022-1, and Arroyo 2022-2). Management considers that Economic book value provides investors with a useful supplemental measure to evaluate our financial position as it reflects the actual financial interest of these investments irrespective of the variable interest consolidation model applied for GAAP reporting purposes. Economic book value does not represent and

should not be considered as a substitute for Stockholders' Equity, as determined in accordance with GAAP, and our calculation of this measure may not be comparable to similarly titled measures reported by other companies.

The table below is a reconciliation of the GAAP Book Value to non-GAAP Economic Book Value (dollars in thousands - except per share data):

	<u>\$ Amount</u>	<u>Per Share</u>
GAAP Book Value at December 31, 2022	\$ 94,804	\$ 15.70
Adjustments to deconsolidate VIEs and reflect our interest in the securities owned		
Deconsolidation of VIEs assets	(2,184,881)	(361.85)
Deconsolidation of VIEs liabilities	2,067,003	342.33
Interest in securities of VIEs owned, at fair value.....	127,081	21.05
Economic Book Value (non-GAAP) at December 31, 2022	\$ 104,007	\$ 17.23

Adjusted Net Investment Income and Net Interest Margin

Adjusted net investment income is a non-GAAP financial measure that is an adjustment to net income which excludes the net interest income for third-party consolidated VIEs, and includes premium amortization for interest rate swaps included in gain/loss on derivative instruments. Adjusted net investment income is used as an input when calculating net interest margin in the below tables and gives investors another view of portfolio performance. Adjusted net investment income may not be comparable to similar measures presented by other companies, as it is a non-GAAP financial measure that is not based on a comprehensive set of accounting rules or principles and therefore may be defined differently by other companies. Adjusted net investment income should be considered in addition to, not as a substitute for, or superior to, financial measures determined in accordance with GAAP.

Adjusted net interest margin is a non-GAAP financial measure calculated by dividing annualized adjusted net investment income for the period by adjusted total investments for the period. Adjusted net interest margin provides investors visibility into the Company's profitability of interest income versus interest expense after excluding consolidating VIEs and adding the net effect of our interest rate swaps and derivatives. However, since adjusted net interest margin is an adjusted measure derived from net investment income (non-GAAP), and differs from net income (loss) as computed in accordance with GAAP, which may not be comparable to similar measures provided by other companies it should be considered as supplementary to, and not as a substitute for, net income margin computed by net income (loss) in accordance with GAAP.

The following tables set forth certain information regarding our non-GAAP adjusted net investment income and adjusted net interest margin which includes interest income on Agency and Non-Agency Interest-Only Strips classified as derivatives and excludes the interest expense for third-party consolidated VIEs for the years ended December 31, 2022, December 31, 2021 and December 31, 2020 (dollars in thousands):

<u>Year ended December 31, 2022</u>	<u>Average Amortized Cost of Assets⁽¹⁾</u>	<u>Total Interest Income⁽²⁾</u>	<u>Yield on Average Assets</u>
Investments			
Agency RMBS	\$ 1,023	\$ 61	5.96%
Non-Agency RMBS	41,814	2,108	5.04%
Non-Agency CMBS	133,266	9,744	7.31%
Residential Whole Loans.....	1,176,706	48,269	4.10%
Residential Bridge Loans	5,364	1,223	22.80%
Commercial Loans	188,016	5,535	2.94%
Securitized commercial loans	1,274,894	88,171	6.92%
Other securities.....	44,677	3,657	8.19%
Total investments	<u>\$ 2,865,760</u>	<u>\$ 158,768</u>	<u>5.54%</u>
<i>Adjustments:</i>			
Securitized commercial loans from consolidated VIEs	(1,274,894)	(88,171)	6.92%
Investments in consolidated VIEs eliminated in consolidation	13,966	881	6.31%
Adjusted total investments.....	<u>\$ 1,604,832</u>	<u>\$ 71,478</u>	<u>4.45%</u>

	<u>Average Carrying Value</u>	<u>Total Interest Expense</u>	<u>Average Effective Cost of Funds</u>
Borrowings			
Repurchase agreements	\$ 357,536	\$ 12,176	3.41%
Convertible senior unsecured notes, net	106,099	9,364	8.83%
Securitized debt	2,176,270	116,192	5.34%
Interest rate swaps	n/a	(628)	(0.02)%
Total borrowings	<u>\$ 2,639,905</u>	<u>\$ 137,104</u>	<u>5.19%</u>
<i>Adjustments:</i>			
Securitized debt from consolidated VIEs ⁽³⁾	\$ (1,267,886)	\$ (84,219)	6.64%
Adjusted total borrowings	<u>\$ 1,372,019</u>	<u>\$ 52,885</u>	<u>3.85%</u>
Adjusted net investment income (non-GAAP) and adjusted net interest margin (non-GAAP)		<u>\$ 18,593</u>	<u>1.16%</u>

(1) Includes Agency and Non-Agency Interest-Only Strips accounted for as derivatives.

(2) Refer to below table for components of interest income.

(3) Includes only the third-party sponsored securitized debt from CMSC USA.

<u>Year ended December 31, 2021</u>	<u>Average Amortized Cost of Assets⁽¹⁾</u>	<u>Total Interest Income⁽²⁾</u>	<u>Yield on Average Assets</u>
Investments			
Agency RMBS	\$ 1,353	\$ 111	8.20%
Non-Agency RMBS	29,128	1,457	5.00%
Non-Agency CMBS	198,214	16,409	8.28%
Residential Whole Loans	917,960	35,092	3.82%
Residential Bridge Loans	10,043	1,099	10.94%
Commercial Loans	270,982	12,537	4.63%
Securitized commercial loans	1,427,347	94,349	6.61%
Other securities	49,330	3,111	6.31%
Total investments	<u>\$ 2,904,357</u>	<u>\$ 164,165</u>	<u>5.65%</u>
<i>Adjustments:</i>			
Securitized commercial loan from consolidated VIEs	(1,427,347)	(94,349)	6.61%
Investments in consolidated VIE eliminated in consolidation	45,647	3,649	7.99%
Adjusted total investments	<u>\$ 1,522,657</u>	<u>\$ 73,465</u>	<u>4.82%</u>

	<u>Average Carrying Value</u>	<u>Total Interest Expense</u>	<u>Average Effective Cost of Funds</u>
Borrowings			
Repurchase agreements	\$ 419,455	\$ 14,517	3.46%
Convertible senior unsecured notes, net	150,961	12,805	8.48%
Securitized debt	2,078,156	109,588	5.27%
Interest rate swaps	—	(109)	—%
Total borrowings	<u>\$ 2,648,572</u>	<u>\$ 136,801</u>	<u>5.17%</u>
<i>Adjustments:</i>			
Securitized debt from consolidated VIEs ⁽³⁾	\$ (1,389,308)	\$ (87,635)	6.31%
Adjusted total borrowings	<u>\$ 1,259,264</u>	<u>\$ 49,166</u>	<u>3.90%</u>
Adjusted net investment income (non-GAAP) and adjusted net interest margin (non-GAAP)		<u>\$ 24,299</u>	<u>1.60%</u>

(1) Includes Agency and Non-Agency Interest-Only Strips accounted for as derivatives.

(2) Refer to below table for components of interest income.

(3) Includes only the third-party sponsored securitized debt from RETL Trust and CMSC USA.

Year ended December 31, 2020	Average Amortized Cost of Assets⁽¹⁾	Total Interest Income⁽²⁾	Yield on Average Assets
Investments			
Agency CMBS	\$ 343,711	\$ 10,751	3.13%
Agency RMBS	61,008	2,165	3.55%
Non-Agency RMBS	32,905	1,539	4.68%
Non-Agency CMBS	262,372	21,798	8.31%
Residential Whole Loans.....	1,223,043	54,359	4.44%
Residential Bridge Loans	26,354	1,756	6.66%
Commercial Loans	337,485	23,194	6.87%
Securitized commercial loan	1,093,487	59,212	5.41%
Other securities.....	53,753	3,482	6.48%
Total investments	<u>\$ 3,434,118</u>	<u>\$ 178,256</u>	<u>4.70%</u>
<i>Adjustments:</i>			
Securitized commercial loan from consolidated VIE	(1,093,487)	(59,212)	5.41%
Investment in consolidated VIE eliminated in consolidation.....	93,688	8,655	9.24%
Adjusted total investments.....	<u>\$ 2,434,319</u>	<u>\$ 127,699</u>	<u>5.25%</u>
	Average Carrying Value	Total Interest Expense⁽³⁾	Average Effective Cost of Funds
Borrowings			
Repurchase agreements	\$ 1,108,838	\$ 35,243	3.18%
Convertible senior unsecured notes, net	193,516	16,252	8.40%
Securitized debt	1,864,964	81,096	4.35%
Interest rate swaps	—	1,133	0.04%
Total borrowings	<u>\$ 3,167,318</u>	<u>\$ 133,724</u>	<u>4.22%</u>
<i>Adjustments:</i>			
Securitized debt from consolidated VIE ⁽⁴⁾	\$ (986,786)	\$ (53,118)	5.38%
Adjusted total borrowings	<u>\$ 2,180,532</u>	<u>\$ 80,606</u>	<u>3.70%</u>
Adjusted net investment income (non-GAAP) and adjusted net interest margin (non-GAAP)		<u>\$ 47,093</u>	<u>1.93%</u>

(1) Includes Agency and Non-Agency Interest-Only Strips accounted for as derivatives.

(2) Refer to below table for components of interest income.

(3) Includes the net amount received/paid, including accrued amounts and premium amortization for MAC interest rate swaps during the periods included in gain/loss on derivative instruments for GAAP.

(4) Includes only the third-party sponsored securitized debt from RETL Trust, CMSC Trust, MRCD Trust and CMSC USA.

The following table reconciles total interest income to adjusted interest income, which includes interest income on Agency and Non-Agency Interest-Only Strips classified as derivatives for the years ended December 31, 2022, December 31, 2021 and December 31, 2020:

(dollars in thousands)	Year ended December 31, 2022	Year ended December 31, 2021	Year ended December 31, 2020
Coupon interest income:			
Agency CMBS	\$ —	\$ —	\$ 11,336
Agency RMBS	13	47	2,975
Non-Agency RMBS	2,154	2,127	2,732
Non-Agency CMBS	9,129	9,874	15,331
Residential Whole Loans	54,206	44,867	59,698
Residential Bridge Loans	1,223	1,121	1,815
Commercial Loans	5,535	12,390	22,832
Securitized commercial loans.....	61,533	69,646	49,370
Other securities	3,383	4,685	8,263
Subtotal coupon interest.....	<u>\$ 137,176</u>	<u>\$ 144,757</u>	<u>\$ 174,352</u>
Premium accretion, discount amortization and amortization of basis, net:			
Agency RMBS	\$ (1)	\$ (30)	\$ (987)
Agency CMBS	—	—	(636)
Non-Agency RMBS	(46)	(670)	(1,193)
Non-Agency CMBS	615	6,535	6,467
Residential Whole Loans	(5,937)	(9,775)	(5,339)
Residential Bridge Loans	—	(22)	(59)
Commercial Loans	—	147	362
Securitized commercial loans.....	26,638	24,703	9,842
Other securities	274	(1,574)	(4,781)
Subtotal accretion and amortization	<u>\$ 21,543</u>	<u>\$ 19,314</u>	<u>\$ 3,676</u>
Interest income	<u>\$ 158,719</u>	<u>\$ 164,071</u>	<u>\$ 178,028</u>
Contractual interest income, net of amortization of basis on Agency and Non-Agency Interest-Only Strips, classified as derivatives⁽¹⁾:			
Coupon interest income	\$ 151	\$ 394	\$ 1,324
Amortization of basis.....	(102)	(300)	(1,096)
Subtotal	<u>\$ 49</u>	<u>\$ 94</u>	<u>\$ 228</u>
Total adjusted interest income (non-GAAP).....	<u>\$ 158,768</u>	<u>\$ 164,165</u>	<u>\$ 178,256</u>

(1) Reported in "Gain (loss) on derivative instruments, net" in our Consolidated Statements of Operations.

Effective Cost of Funds

Effective Cost of Funds includes the net interest component related to our interest rate swaps, as well as the impact of our foreign currency swaps and forwards. While we have not elected hedge accounting for these instruments, such derivative instruments are viewed by us as an economic hedge against increases in future market interest rates on our liabilities and changes in foreign currency exchange rates on our assets and liabilities and are characterized as hedges for purposes of satisfying the REIT requirements and therefore the Effective Cost of Funds reflects interest expense adjusted to include the realized gain/loss (i.e., the interest income/expense component) for all of our interest rate swaps and the impact of our foreign currency swaps and forwards.

The following table reconciles the Effective Cost of Funds (non-GAAP financial measure) with interest expense for the years ended December 31, 2022, December 31, 2021 and December 31, 2020:

(dollars in thousands)	Year ended December 31, 2022		Year ended December 31, 2021		Year ended December 31, 2020	
	Reconciliation	Cost of	Reconciliation	Cost of	Reconciliation	Cost of
		Funds/Effective Borrowing Costs		Funds/Effective Borrowing Costs		Funds/Effective Borrowing Costs
Interest expense	\$ 137,732	5.22%	\$ 136,910	5.17%	\$ 132,591	4.19%
<i>Adjustments:</i>						
Interest expense on Securitized debt from consolidated VIEs.....	(84,219)	(6.64)%	(87,635)	(6.31)%	(53,118)	(5.38)%
Net interest (received) paid — interest rate swaps	(628)	(0.02)%	(109)	—%	1,133	0.04%
Effective Cost of Funds (non-GAAP).....	\$ 52,885	3.85%	\$ 49,166	3.90%	\$ 80,606	3.70%
Weighted average borrowings.....	\$ 1,372,019		\$ 1,259,264		\$ 2,180,532	

Liquidity and Capital Resources

General

Liquidity is a measure of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain our assets and operations, make distributions to our stockholders, and other general business needs. To maintain our REIT qualifications under the Internal Revenue Code, we must distribute annually at least 90% of our taxable income, excluding capital gains and, such distributions requirements limit our ability to retain earnings and increase capital for operations. Our principal sources of funds generally consist of borrowings under repurchase agreements, Residential Whole Loan securitizations, payments of principal and interest we receive on our investment portfolio, cash generated from investment sales and, to the extent such transactions are entered into, proceeds from capital market and unsecured convertible note transactions.

We currently believe we have sufficient liquidity and capital resources available, for at least the next 12 months, to fund our operations, meet our financial obligations, purchase our target assets, and make dividend payments to maintain our REIT qualifications. As of December 31, 2022, we had \$18.0 million in cash and cash equivalents. Our other sources of liquidity were unencumbered investments, and unused borrowing capacity in certain borrowing facilities since the amount borrowed is less than the maximum advance rate.

Sources of Liquidity

Our primary sources of liquidity are as follows:

Cash Generated from Operations

For the year ended December 31, 2022, net cash provided by operating activities was approximately \$15.5 million. This was primarily attributable to margin settlements of interest rate swaps, the net interest income on our investments, realized gain on the sale of an REO hotel, less operating expenses, and general and administrative expenses. For the year ended December 31, 2021, net cash provided by operating activities was approximately \$2.1 million. This was primarily attributable to the net interest income on our investments, less operating expenses, and general and administrative expenses. For the year ended December 31, 2020, net cash used in operating activities was by approximately \$147.6 million. This was primarily attributable to the net loss on our investments net of adjustments pertaining to the amortization/accretion of premiums and discounts and other non-cash items less operating expenses, general and administrative expenses, and margin settlements on our interest rate swaps.

Cash Provided by and Used in Investing Activities

For the year ended December 31, 2022, net cash used in investing activities was approximately \$56.3 million. The net cash provided by investing activity was primarily attributable to purchases of Non-Agency RMBS and residential whole loans during the period, which was partially offset by receipts of principal payments and payoffs on our investments and the sale of an REO hotel and mortgage backed securities. For the year ended December 31, 2021, net cash provided by investing activities was approximately \$512.7 million. The net cash provided by investing activity was primarily attributable to proceeds from payoffs in our commercial and residential whole loans and principal payments on our investments, which was partially offset by our investment acquisitions. For the year ended December 31, 2020, net cash provided by investing activities was approximately \$2.7 billion. This was primarily attributable to proceeds from sales and receipts of principal payments on our investments, which were partially offset by our investment acquisitions.

Cash Provided by and Used in Financing Activities

For the year ended December 31, 2022, net cash provided by financing activities was approximately \$18.6 million. This was primarily attributable to the net cash proceeds from the Arroyo Trust 2022-1 and Arroyo Trust 2022-2 securitizations, which was partially offset by a decrease in repurchase agreement borrowings, paydowns in our securitized debt, and the repayment in full of our 2022 Notes at maturity. For the year ended December 31, 2021, net cash used in financing activities was approximately \$582.0 million. This was primarily attributable to extinguishment of \$137.3 million principal amount of the 2022 Notes, the repayments on securitized debt, and distribution of escrows related to consolidated VIEs and the payment of dividends on our common stock. The proceeds from the issuance of the 2024 Notes partially offset the net cash used in financing activities. For the year ended December 31, 2020, net cash used in financing activities was approximately \$2.5 billion. This was primarily attributable to net repayments of our repurchase agreement borrowings. Our net cash provided by financing activities was partially offset by dividends paid on our common stock.

Financing Facilities

Repurchase Agreements

As of December 31, 2022, we had borrowings under six of our master repurchase agreements of approximately \$193.1 million. The following table presents our repurchase agreement borrowings, by type of collateral pledged, as of December 31, 2022 and December 31, 2021, and the respective effective cost of funds (non-GAAP financial measure) for the years ended December 31, 2022 and December 31, 2021, respectively. See “Non-GAAP Financial Measures” (dollars in thousands):

Collateral	Borrowings Outstanding	Value of Collateral Pledged	Weighted Average Interest Rate end of period	Weighted Average Cost of Funds	Weighted Average Effective Cost of Funds (Non-GAAP) ⁽¹⁾	Weighted Average Haircut end of period
December 31, 2022						
Agency RMBS, at fair value	\$ 293	\$ 249	4.78%	2.00%	2.00%	25.00%
Non-Agency RMBS, at fair value ⁽²⁾	67,366	104,487	7.16%	4.25%	4.25%	45.25%
Non-Agency CMBS, at fair value ⁽²⁾	55,154	83,925	6.30%	3.49%	3.49%	40.00%
Residential Whole Loans, at fair value ⁽³⁾	3,633	3,229	6.66%	2.75%	2.75%	10.00%
Residential Bridge Loans ⁽³⁾	—	—	—%	3.88%	3.88%	—%
Commercial Loans, at fair value ⁽³⁾	48,032	66,864	6.13%	3.82%	3.82%	28.23%
Other securities, at fair value	18,639	27,262	6.38%	3.49%	3.49%	37.38%
Interest rate swaps	n/a	n/a	n/a	n/a	(0.18)%	n/a
Total	<u>\$ 193,117</u>	<u>\$ 286,016</u>	<u>6.57%</u>	<u>3.41%</u>	<u>3.23%</u>	<u>38.06%</u>
December 31, 2021						
Agency RMBS, at fair value	\$ 976	\$ 1,172	1.02%	1.10%	1.10%	25.00%
Non-Agency RMBS, at fair value	38,354	66,555	2.94%	3.10%	3.10%	39.29%
Non-Agency CMBS, at fair value	—	107,624	—%	3.04%	3.04%	40.00%
Residential Whole Loans, at fair value ⁽³⁾	397,970	453,447	2.31%	4.86%	4.86%	10.00%
Residential Bridge Loans ⁽³⁾	4,368	5,207	2.61%	2.68%	2.68%	20.00%
Commercial Loans, at fair value ⁽³⁾	70,124	101,459	2.36%	2.62%	2.62%	29.73%
Membership interest ⁽⁴⁾	2,457	51,648	3.50%	2.78%	2.78%	37.05%
Other securities, at fair value	—	—	2.90%	3.02%	3.02%	—%
Interest rate swaps	n/a	n/a	n/a	n/a	(0.03)%	n/a
Total	<u>\$ 514,249</u>	<u>\$ 787,112</u>	<u>2.30%</u>	<u>3.46%</u>	<u>3.43%</u>	<u>19.14%</u>

(1) Weighted Average Effective Cost of Funds (non-GAAP) for the period presented is calculated on an annualized basis and includes interest expense for the period and net periodic interest payments on interest rate swaps of approximately \$628 thousand received and \$109 thousand received for the years ended December 31, 2022 and 2021, respectively. While interest rate swaps are not accounted for using hedge accounting, such instruments are viewed by us as an economic hedge against increases in interest rates on our liabilities and are treated as hedges for purposes of satisfying the REIT requirements. See “Non-GAAP Financial Measures.”

(2) Includes repurchase agreement borrowings on securities eliminated upon VIE consolidation.

(3) Repurchase agreement borrowings collateralized by Whole Loans, Bridge Loans and securitized commercial loans owned through trust certificates. The trust certificates are eliminated upon consolidation.

(4) The pledged amount relates to our non-controlling membership interest in our wholly owned subsidiary, WMC RETL LLC, which was financed under a repurchase agreement. The membership interest is eliminated in consolidation.

In connection with our repurchase agreement financings and interest rate swaps, we may receive margin calls or make a margin call from our counterparties. Our ability to meet future margin calls will be affected by our ability to use cash, draw on the unused capacity existing on financing facilities or obtain financing from unpledged collateral, the amount of which can vary based on the market value of such collateral. Our cash position fluctuates based on the timing of our operating, investing, and financing activities and is managed based on our anticipated cash needs. In 2022, we met our margin calls, and the cash collateral related to margin calls held by counterparties on December 31, 2022, was approximately \$3.4 million.

At-The-Market Program

In March 2017, we entered into an equity distribution agreement with JPM Securities LLC, or “JMP”, which was amended on June 5, 2020, under which we may offer and sell up to \$100 million in shares of common stock in an At-The-Market equity offering from time to time through JMP.

Contractual Obligations and Commitments

Our contractual obligations as of December 31, 2022 are as follows (dollars in thousands):

	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years	Total
Borrowings under repurchase agreements.....	\$ 193,117	\$ —	\$ —	\$ —	\$ 193,117
Contractual interest on repurchase agreements	7,715	—	—	—	7,715
Convertible senior unsecured notes.....	—	86,250	—	—	86,250
Contractual interest on convertible senior unsecured notes	5,822	5,822	—	—	11,644
Securitized debt ⁽²⁾	—	1,370,692	—	1,041,137	2,411,829
Contractual interest on securitized debt	93,800	173,568	75,342	1,038,174	1,380,884
Total	<u>\$ 300,454</u>	<u>\$ 1,636,332</u>	<u>\$ 75,342</u>	<u>\$ 2,079,311</u>	<u>\$ 4,091,439</u>

(1) The table above does not include amounts due under the Management Agreement (as defined herein) with our Manager, as those obligations do not have fixed and determinable payments.

(2) The securitized debt is non-recourse to us and can only be settled with the loans that serve as collateral. The collateral for the securitized debt has a principal balance of \$2.5 billion. Assumes entire outstanding principal balance at December 31, 2022 is paid at maturity.

Management Agreement

On May 9, 2012, we entered into a management agreement (the “Management Agreement”) with our Manager which describes the services to be provided by our Manager and compensation for such services. Our Manager is responsible for managing our operations, including: (i) performing all of our day-to-day functions; (ii) determining investment criteria in conjunction with our Board of Directors; (iii) sourcing, analyzing and executing investments, asset sales and financings; (iv) performing asset management duties; and (v) performing financial and accounting management, subject to the direction and oversight of our Board of Directors. Pursuant to the terms of the Management Agreement, our Manager is paid a management fee equal to 1.50% per annum of our stockholders’ equity, (as defined in the Management Agreement), calculated and payable (in cash) quarterly in arrears. The Manager waived the management fee for March 2020 through May 2020 because of the unprecedented market disruption and dislocation across fixed income markets surrounding the uncertainty related to COVID-19 pandemic. In December 2021, the Manager agreed to voluntarily waive 25% of its management fee solely for the duration of calendar year 2022 in order to support the earnings potential of the Company and its transition to a residential focused investment portfolio. Future waivers, if any, are at the Manager’s discretion. Refer to Note 10, “Related Party Transactions” to the consolidated financial statements contained in this Annual Report on Form 10-K.

Off-Balance Sheet Arrangements

We do not have any relationships with any entities or financial partnerships, such as entities often referred to as structured investment vehicles, or special purpose or variable interest entities, established to facilitate off-balance sheet arrangements or other contractually narrow or limited purposes.

Further, other than guaranteeing certain obligations of our wholly-owned taxable REIT subsidiary or TRS and the obligations of our wholly-owned subsidiary, WMC CRE LLC, we have not guaranteed any obligations of any entities or entered into any commitment to provide additional funding to any such entities.

Dividends

To maintain our qualification as a REIT, U.S. federal income tax law generally requires that we distribute at least 90% of our REIT taxable income annually, determined without regard to the deduction for dividends paid and excluding net capital gains. We must pay tax at regular corporate rates to the extent that we annually distribute less than 100% of our taxable income.

We evaluate each quarter to determine our ability to pay dividends to our stockholders based on our net taxable income if and to the extent authorized by our Board of Directors. 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 payments. 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.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We seek to manage the risks related to the credit quality of our assets, interest rates, liquidity, prepayment speeds and market values while, at the same time, seeking to provide an opportunity to stockholders to realize attractive risk-adjusted returns from our assets through ownership of our common stock. While we do not seek to avoid risk completely, our Manager seeks to actively manage risk for us, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

Credit Risk

We are subject to varying degrees of credit risk in connection with our assets. Although we do not expect to encounter credit risk in our Agency CMBS and Agency RMBS, we are exposed to the risk of potential credit losses from general credit spread widening related to Non-Agency RMBS, Non-Agency CMBS, Residential Whole Loans, Residential Bridge Loans, Commercial Loans and other portfolio investments in addition to unexpected increase in borrower defaults on these investments. Investment decisions are made following a bottom-up credit analysis and specific relevant risk assumptions. As part of the risk management process, our Manager uses detailed proprietary models, applicable to evaluate, depending on the asset class, house price appreciation and depreciation by region, prepayment speeds and foreclosure/default frequency, cost and timing. If our Manager determines that the proposed investment can meet the appropriate risk and return criteria as well as complement our existing asset portfolio, the investment will undergo a more thorough analysis.

As of December 31, 2022, three of the counterparties with which we had outstanding repurchase agreement borrowings held collateral which we posted as security for such borrowings in excess of 5% of our stockholders' equity. Prior to entering into a repurchase agreement with any particular institution, our Manager does a thorough review of such potential counterparty. Such review, however, does not assure the creditworthiness of such counterparty nor that the financial wherewithal of the counterparty will not deteriorate in the future.

Interest Rate Risk

Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political considerations, as well as other factors beyond our control. We are subject to interest rate risk in connection with our assets and our related financing obligations. In general, we expect to finance the acquisition of our assets through financings in the form of repurchase agreements, warehouse facilities, securitizations, bank credit facilities (including term loans and revolving facilities) and public and private equity and debt issuances in addition to transaction or asset specific funding arrangements. Subject to maintaining our qualification as a REIT for U.S. federal income tax purposes, we may utilize derivative financial instruments to hedge the interest rate risk associated with our borrowings. These hedging activities may not be effective. We also may engage in a variety of interest rate management techniques that seek to mitigate changes in interest rates or other potential influences on the values of our assets.

Interest Rate Effect on Net Interest Income

Our operating results will depend in large part on differences between the income earned on our assets and our borrowing costs. The cost of our borrowings is generally based on prevailing market interest rates. During a period of rising interest rates, our borrowing costs generally will increase and the yields earned on our leveraged fixed-rate mortgage assets will remain static. Further, the cost of such financing could increase at a faster pace than the yields earned on our leveraged ARM and hybrid ARM assets. This could result in a decline in our net interest spread and net interest margin. The severity of any such decline would depend on our asset/liability composition at the time as well as the magnitude and duration of the interest rate increase. Further, an increase in short-term interest rates could also have a negative impact on the market value of our assets. If any of these events happen, we could experience a decrease in net income or incur a net loss during these periods, which could adversely affect our liquidity and results of operations.

Interest Rate Cap Risk

To the extent we invest in adjustable-rate RMBS and Whole-Loans, such instruments may be subject to interest rate caps, which potentially could cause such instruments to acquire many of the characteristics of fixed-rate securities if interest rates were to rise above the cap levels. This issue is magnified to the extent we acquire ARM and hybrid ARM assets that are not based on mortgages which are fully indexed. In addition, ARM and hybrid ARM assets may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding or a portion of the incremental interest rate increase being deferred. To the extent we invest in such ARM and/or hybrid ARM assets, we could potentially receive less cash income on such assets than we would need to pay the interest cost on our related borrowings. To mitigate interest rate mismatches, we may utilize the hedging strategies discussed above under "Interest Rate Risk."

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. See "Market Risk" below.

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.

Market Risk

Our MBS and other assets are reflected at their fair value with unrealized gains and losses included in earnings. The fair value of our investments fluctuates primarily due to changes in interest rates and other factors. Generally, in a rising interest rate environment, the fair value of these assets would be expected to decrease; conversely, in a decreasing interest rate environment, the 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, including interest rate swaps, Interest-Only Strips, and net interest income at December 31, 2022, assuming a static portfolio of assets. 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 utilizes our Manager's assumptions, models and estimates, which are based on our Manager's judgment and experience.

Change in Interest Rates	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value
+1.00%	(107.97)%	(1.42)%
+0.50%	(54.01)%	(0.71)%
-0.50%	54.09%	0.73%
-1.00%	108.25%	1.47%

While the table above reflects the estimated immediate impact of interest rate increases and decreases on a static portfolio, we may rebalance our portfolio from time to time either to seek to take advantage of or reduce the impact of changes in interest rates. It is important to note that the impact of changing interest rates on market value and net interest income can change significantly when interest rates change beyond 100 basis points from current levels. Therefore, the volatility in the market value of our assets could increase significantly when interest rates change beyond amounts shown in the table above. In addition, other factors impact the market value of and net interest income from our interest rate-sensitive investments and derivative instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, interest income would likely differ from that shown above and such difference might be material and adverse to our stockholders.

Certain assumptions have been made in connection with the calculation of the information set forth in the table above and, as such, there can be no assurance that assumed events will occur or that other events will not occur that would affect the outcomes. The base interest rate scenario assumes interest rates at December 31, 2022. The analysis presented utilizes assumptions and estimates based on our Manager's judgment and experience. Furthermore, while we generally expect to retain such assets and the associated interest rate risk, future purchases and sales of assets could materially change our interest rate risk profile.

Prepayment Risk

The value of our Agency and Non-Agency RMBS and our Residential Whole Loans may be affected by prepayment rates on the underlying residential mortgage. We acquire RMBS and Residential Whole Loans and anticipate that the underlying residential mortgages will prepay at a projected rate generating an expected yield. If we purchase assets at a premium to par value, when borrowers prepay their residential mortgage loans faster than expected, the corresponding prepayments may reduce the expected yield on our residential mortgage assets because we will have to amortize the related premium on an accelerated basis and, in the case of Agency RMBS, other than interest-only strips, and certain other investment grade rated securities, we are required to make a retrospective adjustment to historical amortization. Conversely, if we purchase assets at a discount to par value, when borrowers prepay their residential mortgage loans slower than expected, such decrease may reduce the expected yield on such assets because we will not be able to accrete the related discount as quickly as originally anticipated and, in the case of Agency RMBS, other than interest-only strips, and certain other investment grade rated securities, we will be required to make a retrospective adjustment to historical amortization.

The value of our Agency and Non-Agency CMBS, as well as Commercial Whole Loans, will also be affected by prepayment rates; however, commercial mortgages frequently limit the ability of the borrower to prepay, thereby providing a certain level of prepayment protection. Common restrictions include yield maintenance and prepayment penalties, the proceeds of which are generally at least partially allocable to these securities, as well as defeasance.

Likewise, the value of our ABS and other structured securities will also be affected prepayment rates. The collateral underlying such securities may, similar to most residential mortgages, allow the borrower to prepay at any time or, similar to commercial mortgages, limit the ability of the borrower to prepay by imposing lock-out provisions, prepayment penalties and/or make whole provisions.

Extension Risk

Most residential mortgage loans do not prohibit the partial or full prepayment of principal outstanding. Accordingly, while the stated maturity of a residential mortgage loan may be 30 years, or in some cases even longer, historically the vast majority of residential mortgage loans are satisfied prior to their maturity date. In periods of rising interest rates, borrowers have less incentive to refinance their existing mortgages and mortgage financing may not be as readily available. This generally results

in a slower rate of prepayments and a corresponding longer weighted average life for RMBS and Residential Whole Loans. The increase, or extension, in weighted average life is commonly referred to as “Extension Risk” which can negatively impact our portfolio. To the extent we receive smaller pre-payments of principal, we will have less capital to invest in new assets. This is extremely detrimental in periods of rising interest rates as we will be unable to invest in new higher coupon investments and a larger portion of our portfolio will remain invested in lower coupon investments. Further, our borrowing costs are generally short-term and, even if hedged, are likely to increase in a rising interest rate environment, thereby reducing our net interest margin. Finally, to the extent we acquired securities at a discount to par, a portion of the overall return on such investments is based on the recovery of this discount. Slower principal prepayments will result in a longer recovery period and a lower overall return on our investment.

Prepayment rates on Agency and Non-Agency CMBS, as well as Commercial Whole Loans, are generally less volatile than residential mortgage assets as commercial mortgages usually limit the ability of the borrower to prepay the mortgage prior to maturity or a period shortly before maturity. Accordingly, extension risk for Agency and Non-Agency CMBS and Commercial Whole Loans is generally less than RMBS and Residential Whole Loans as it is presumed that other than defaults (i.e., involuntary prepayments), most commercial mortgages will remain outstanding for the contractual term of the mortgage.

Prepayment rates on ABS and our other structured securities will be determined by the underlying collateral. The extension risk of such securities will generally be less than residential mortgages, but greater than commercial mortgages.

Real Estate Risk

Residential and commercial property values are subject to volatility and may be adversely affected 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; 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.

Counterparty Risk

The following discussion on counterparty risk reflects how these transactions are structured, rather than how they are presented for financial reporting purposes.

When we engage in repurchase transactions, we generally sell securities to lenders (i.e., repurchase agreement counterparties) and receive cash from the lenders. The lenders are obligated to resell the same securities back to us at the end of the term of the transaction. Because the cash we receive from the lender when we initially sell the securities to the lender is less than the value of those securities (this difference is the haircut), if the lender defaults on its obligation to resell the same securities back to us, we could incur a loss on the transaction up to the amount of the haircut (assuming there was no change in the value of the securities).

If a counterparty to a bi-lateral interest rate swap cannot perform under the terms of the interest rate swap, we may not receive payments due under that agreement, and thus, we may lose any unrealized gain associated with the interest rate swap. We may also risk the loss of any collateral we have pledged to secure our obligations under interest rate swap if the counterparty becomes insolvent or files for bankruptcy. In the case of a cleared swap, if our clearing broker were to default, become insolvent or file for bankruptcy, we may also risk the loss of any collateral we have posted to the clearing broker unless we were able to transfer or “port” our positions and held collateral to another clearing broker. In addition, the interest rate swap would no longer mitigate the impact of changes in interest rates as intended. Most of our interest swaps are currently cleared through a central clearing house which reduces but does not eliminate the aforementioned risks. Also see “Liquidity Risk” below.

Prior to entering into a trading agreement or transaction with any particular institution where we take on counterparty risk, our Manager does a thorough review of such potential counterparty. Such review, however, does not assure the creditworthiness of such counterparty nor that the financial wherewithal of the counterparty will not deteriorate in the future.

Funding Risk

We have financed a substantial majority of our assets with repurchase agreement financing. Over time, as market conditions change, in addition to these financings, we may use other forms of leverage. Changes in the regulatory environment, as well as, weakness in the financial markets, the residential mortgage markets, the commercial mortgage markets, the asset-backed securitization markets and the economy generally could adversely affect one or more of our potential lenders and could cause one or more of our potential lenders to be unwilling or unable to provide us with financing or to increase the costs of that financing.

Liquidity Risk

Our liquidity risk is principally associated with the financing of long-maturity assets with short-term borrowings in the form of repurchase agreements. Although the interest rate adjustments of these assets and liabilities fall within the guidelines established by our operating policies, maturities are not required to be, nor are they, matched.

Should the value of our assets pledged as collateral suddenly decrease, margin calls relating to our repurchase agreements could increase, causing an adverse change in our liquidity position. Our inability to post adequate collateral for a margin call by the counterparty could result in a condition of default under our repurchase agreements, thereby enabling the

counterparty to liquidate the collateral pledged by us, which may have a material adverse consequence on our business and results of operations.

In an instance of severe volatility, or where the additional stress on liquidity resulting from volatility is sustained over an extended period of time, we could be required to sell securities, possibly even at a loss to generate sufficient liquidity to satisfy collateral and margin requirements which could have a material adverse effect on our financial position, results of operations and cash flows.

Additionally, if one or more of our repurchase agreement counterparties chose not to provide on-going funding, our ability to finance would decline or exist at possibly less advantageous terms. Further, if we are unable to renew, replace or expand repurchase financing with other sources of financing on substantially similar terms, it may have a material adverse effect on our business, financial position, results of operations and cash flows, due to the long-term nature of our investments and relatively short-term maturities of our repurchase agreements. As such, there is no assurance that we will always be able to roll over our repurchase agreements.

The costs associated with our borrowings are generally based on prevailing market interest rates. During a period of rising interest rates, our borrowing costs generally will increase while the yields earned on our existing portfolio of leveraged fixed-rate MBS and other fixed rate assets will remain static. Further, certain of our floating rate assets may contain annual or lifetime interest rate caps as well as limit the frequency or timing of changes to the underlying interest rate index. This could result in a decline in our net interest spread and net interest margin. The severity of any such decline would depend on our asset/liability composition at the time, as well as the magnitude and duration of the interest rate increase. Further, an increase in short-term interest rates could also have a negative impact on the market value of our assets. If any of these events happen, we could experience a decrease in net income or incur a net loss during these periods, which could have a material adverse effect on our liquidity and results of operations.

In addition, the assets that comprise our investment portfolio are not traded on a public exchange. A portion of these assets may be subject to legal and other restrictions on resale or will otherwise be less liquid than publicly traded securities. The illiquidity of our assets may make it difficult for us to sell such assets if the need or desire arises, including in response to changes in economic and other conditions. Recent regulatory changes have imposed new capital requirements and other restrictions on banks and other market intermediaries' ability and desire to hold assets on their balance sheets and otherwise make markets in fixed income securities and other assets resulting in reduced liquidity in many sectors of the market. This regulatory trend is expected to continue. As a result of these developments, it may become increasingly difficult for us to sell assets in the market, especially in credit oriented sectors such as Non-Agency RMBS and CMBS, ABS and Whole Loans.

We enter into interest rate swaps to manage our interest rate risk. We are required to pledge cash or securities as collateral as part of a margin arrangement, calculated daily, in connection with the interest rate swaps. The amount of margin that we are required to post will vary and generally reflects collateral required to be posted with respect to interest rate swaps that are in an unrealized loss position to us and is generally based on a percentage of the aggregate notional amount of interest rate swaps per counterparty. Margin calls could adversely affect our liquidity. Our inability to post adequate collateral for a margin call could result in a condition of default under our interest rate swap agreements, thereby resulting in liquidation of the collateral pledged by us, which may have a material adverse consequence on our business, financial position, results of operations and cash flows. Conversely, if our interest rate swaps are in an unrealized gain position, our counterparties to bilateral swaps are required to post collateral with us, under the same terms that we post collateral with them. We at times enter into a MAC interest rate swap in which we receive or make a payment at the time of entering such interest rate swap to compensate for the out of the market nature of such interest rate swap. Similar to all other interest rate swaps, MAC interest rate swaps are subject to the margin requirements previously described.

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 so than does inflation. Changes in interest rates do not necessarily directly correlate with inflation rates or changes in inflation rates. Our consolidated financial statements are prepared in accordance with GAAP and our distributions will be determined by our Board of Directors consistent with our obligation to distribute to our stockholders at least 90% of our net taxable income on an annual basis, in accordance with the REIT regulations, in order to maintain our REIT qualification. In each case, our activities and consolidated balance sheets are measured with reference to historical cost and/or fair market value without considering inflation.

Foreign Investment risk

We have invested in non U.S. CMBS transactions and, in the future, we may make other investments in non U.S. issuers and transactions. These investments present certain unique risks, including those resulting from future political, legal, and economic developments, which could include favorable or unfavorable changes in currency exchange rates, exchange control regulations (including currency blockage), expropriation, nationalization, or confiscatory taxation of assets, adverse changes in investment capital or exchange control regulations (which may include suspension of the ability to transfer currency from a country), political changes, diplomatic developments, difficulty in obtaining and enforcing judgments against non U.S. entities, the possible imposition of the applicable country's governmental laws or restrictions, and the reduced availability of public information concerning issuers. In the event of a nationalization, expropriation, or other confiscation of assets, we could lose our entire investment in a security. Legal remedies available to investors in certain jurisdictions may be more limited than those available to investors in the United States. Issuers of non U.S. securities may not be subject to the same degree of regulation as U.S. issuers.

Furthermore, non U.S. issuers are not generally subject to uniform accounting, auditing, and financial reporting standards or other regulatory practices and requirements comparable to those applicable to U.S. issuers. There is generally less government supervision and regulation of non U.S. exchanges, brokers, and issuers than there is in the United States, and there is greater difficulty in taking appropriate legal action in non U.S. courts. There are also special tax considerations that apply to securities of non U.S. issuers and securities principally traded overseas.

To the extent that our investments are denominated in U.S. dollars, these investments are not affected directly by changes in currency exchange rates relative to the dollar and exchange control regulations. We are, however, subject to currency risk with respect to such investments to the extent that a decline in a non U.S. issuer's or borrower's own currency relative to the dollar may impair such issuer's or borrower's ability to make timely payments of principal and/or interest on a loan or other debt security. To the extent that our investments are in non-dollar denominated securities, the value of the investment and the net investment income available for distribution may be affected favorably or unfavorably by changes in currency exchange rates relative to the dollar and exchange control regulations.

Currency exchange rates can be volatile and affected by, among other factors, the general economics of a country, the actions of governments or central banks and the imposition of currency controls and speculation. In addition, a security may be denominated in a currency that is different from the currency where the issuer is domiciled.

Currency Risk

We have and may continue in the future to invest in assets which are denominated in a currency other than U.S. dollars and may finance such investments with repurchase financing or other forms of financing which may also be denominated in a currency other than U.S. dollars. To the extent we make such investments and/or enter into such financing arrangements, we may utilize foreign currency swaps, forwards or other derivative instruments to hedge our exposure to foreign currency risk. Despite being economic hedges, we have elected not to treat such derivative instruments as hedges for accounting purposes and therefore the changes in the value of such instruments, including actual and accrued payments, will be included in our Consolidated Statements of Operations. While such transactions are entered into in an effort to minimize our foreign currency risk, there can be no assurance that they will perform as expected. If actual prepayments of the foreign denominated asset are faster, or slower, than expected, the hedge instrument is unlikely to fully protect us from changes in the valuation of such foreign currency. Further, as with interest rate swaps, there is counterparty risk associated with the future creditworthiness of such counterparty.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Financial Statements Schedules other than the one listed above are omitted because the required information is not applicable or deemed not material, or the required information is presented in the financial statements and/or in the notes to financial statements.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Western Asset Mortgage Capital Corporation

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Western Asset Mortgage Capital Corporation and its subsidiaries (the “Company”) as of December 31, 2022 and 2021, and the related consolidated statements of operations, of changes in stockholders’ equity and of cash flows for each of the three years in the period ended December 31, 2022, including the related notes and financial statement schedule listed in the accompanying index (collectively referred to as the “consolidated financial statements”). We also have audited the Company’s internal control over financial reporting as of December 31, 2022, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2022 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2022, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the COSO.

Basis for Opinions

The Company’s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management’s Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on the Company’s consolidated financial statements and on the Company’s internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Critical Audit Matters

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that (i) relates to accounts or disclosures that are material to the consolidated financial statements and (ii) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Valuation of Non-Qualified Residential Whole Loans

As described in Note 3 to the consolidated financial statements, the fair value of the Company's Non-Qualified Residential Whole Loans ("Non-QM") was \$377.1 million as of December 31, 2022. The Company's valuation is based upon prices obtained from an independent third-party pricing service that specializes in loan valuation, utilizing a discounted cash flow valuation model that is calibrated to recent loan trade execution. The valuation methodology incorporates commonly used market pricing methods, which include the inputs considered most significant to the determination of fair value of the Company's residential whole loans. The assumptions made by the independent third-party pricing service include the market discount rate, default assumption, loss severity and prepayment speeds.

Management reviews the analysis provided by pricing service as well as the key assumptions made available to the company.

The principal considerations for our determination that performing procedures relating to the valuation of the Company's Non-QM Residential Whole Loans is a critical audit matter are the significant judgment by management to determine the fair value of these loans, which included significant assumptions related to the market discount rate, default assumption, loss severity and prepayment speeds, which in turn led to a high degree of auditor subjectivity, judgment, and effort in performing audit procedures and evaluating the audit evidence obtained related to the valuation and the audit effort involved the use of professionals with specialized skill and knowledge.

Addressing the matter involved performing procedures and evaluating audit evidence in connection with forming our overall opinion on the consolidated financial statements. These procedures included testing the effectiveness of controls relating to the valuation of Non-QM Residential Whole Loans, including controls over management's loan data and the prices and significant assumptions received from the independent third-party pricing service. These procedures also included, among others, (i) the involvement of professionals with specialized skill and knowledge to assist in developing an independent range of prices for the Non-QM Residential Whole Loan portfolio and (ii) comparing the independent range to management's estimate to evaluate the reasonableness of management's estimate. Developing the independent estimate involved (i) testing the loan data provided by management and (ii) independently developing the assumptions related to the discount rate, default assumptions, loss severity and prepayment speeds by utilizing data obtained from market sources and observable transactions under a variety of macroeconomic scenarios.

/s/ PricewaterhouseCoopers LLP

Los Angeles, California
March 10, 2023

We have served as the Company's auditor since 2011.

Western Asset Mortgage Capital Corporation and Subsidiaries
Consolidated Balance Sheets
(in thousands—except share and per share data)

	December 31, 2022	December 31, 2021
Assets:		
Cash and cash equivalents	\$ 18,011	\$ 40,193
Restricted cash	248	260
Agency mortgage-backed securities, at fair value (\$249 and \$1,172 pledged as collateral, at fair value, respectively)	767	1,172
Non-Agency mortgage-backed securities, at fair value (\$100,115 and \$123,947 pledged as collateral, at fair value, respectively).....	109,122	133,127
Other securities, at fair value (\$27,262 and \$51,648 pledged as collateral, at fair value, respectively)	27,262	51,648
Residential Whole Loans, at fair value (\$1,089,914 and \$1,023,502 pledged as collateral, at fair value, respectively)	1,091,145	1,023,502
Residential Bridge Loans, at fair value (None and \$5,207 pledged as collateral, at fair value, respectively).....	2,849	5,428
Securitized commercial loans, at fair value	1,085,103	1,355,808
Commercial Loans, at fair value (\$66,864 and \$101,459 pledged as collateral, at fair value, respectively).....	90,002	130,572
Investment related receivable	5,960	22,133
Interest receivable	11,330	11,823
Due from counterparties	6,574	4,565
Derivative assets, at fair value	1	105
Other assets	4,860	45,364
Total Assets⁽¹⁾.....	\$ 2,453,234	\$ 2,825,700
Liabilities and Stockholders' Equity:		
Liabilities:		
Repurchase agreements, net.....	\$ 193,117	\$ 617,189
Convertible senior unsecured notes, net	83,522	119,168
Securitized debt, net (\$1,719,865 and \$1,344,370 at fair value and \$128,217 and \$180,116 held by affiliates, respectively).....	2,058,684	1,863,488
Interest payable (includes \$655 and \$699 on securitized debt held by affiliates, respectively)	12,794	10,272
Due to counterparties	300	—
Derivative liability, at fair value	61	602
Accounts payable and accrued expenses	3,201	4,842
Payable to affiliate	4,028	1,925
Dividend payable	2,415	3,623
Other liabilities	300	262
Total Liabilities⁽²⁾.....	2,358,422	2,621,371
Commitments and contingencies (Note 15)		
Stockholders' Equity⁽³⁾:		
Common stock, \$0.01 par value, 50,000,000 shares authorized, and 6,038,012 and 6,038,010 outstanding, respectively	60	60
Preferred stock, \$0.01 par value, 10,000,000 shares authorized and no shares outstanding	—	—
Treasury stock, at cost, 57,981 and 57,981 shares held, respectively	(1,665)	(1,665)
Additional paid-in capital	919,238	918,695
Retained earnings (accumulated deficit).....	(822,829)	(723,981)
Total Stockholders' Equity.....	94,804	193,109
Non-controlling interest.....	8	11,220
Total Equity.....	94,812	204,329
Total Liabilities and Stockholders' Equity.....	\$ 2,453,234	\$ 2,825,700

See notes to consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries
Consolidated Balance Sheets
(in thousands—except share and per share data)

	December 31, 2022	December 31, 2021
(1) Assets of consolidated VIEs included in the total assets above:		
Cash and cash equivalents.....	\$ —	\$ 266
Restricted cash.....	248	260
Residential Whole Loans, at fair value (\$1,089,914 and \$1,023,502 pledged as collateral, at fair value, respectively).....	1,091,145	1,023,502
Residential Bridge Loans, at fair value (None and \$5,207 pledged as collateral, at fair value, respectively).....	2,849	5,207
Securitized commercial loans, at fair value.....	1,085,103	1,355,808
Commercial Loans, at fair value (None and \$14,362 pledged as collateral, at fair value, respectively).....	14,362	14,362
Investment related receivable.....	5,914	22,087
Interest receivable.....	10,182	10,572
Other assets.....	509	—
Total assets of consolidated VIEs.....	\$ 2,210,312	\$ 2,432,064
(2) Liabilities of consolidated VIEs included in the total liabilities above:		
Securitized debt, net (\$1,719,865 and \$1,344,370 at fair value and \$128,217 and \$180,116 held by affiliates, respectively).....	\$ 2,058,684	\$ 1,863,488
Interest payable (includes \$655 and \$699 on securitized debt held by affiliates, respectively).....	8,303	6,480
Accounts payable and accrued expenses.....	43	78
Other liabilities.....	248	260
Total liabilities of consolidated VIEs.....	\$ 2,067,278	\$ 1,870,306

(3) Amounts have been adjusted to reflect the one-for-ten reverse stock split effected July 11, 2022. See Note 2, “Basis of Presentation and Summary of Significant Accounting Policies” and Note 12, “Stockholders’ Equity” to the consolidated financial statements contained in this Annual Report on Form 10-K for additional details.

See notes to consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries
Consolidated Statements of Operations
(in thousands—except share and per share data)

	For the years ended December 31,		
	2022	2021	2020
Net Interest Income			
Interest income.....	\$ 158,719	\$ 164,071	\$ 178,028
Interest expense (includes \$13,757, \$14,341 and \$8,877 on securitized debt held by affiliates, respectively).....	137,732	136,910	132,591
Net Interest Income	20,987	27,161	45,437
Other Income (Loss)			
Realized gain (loss), net.....	(36,669)	(10,927)	84,271
Unrealized loss, net.....	(63,874)	(46,391)	(221,387)
Gain (loss) on derivative instruments, net	16,218	549	(197,703)
Other, net	(147)	490	339
Other Income (Loss)	(84,472)	(56,279)	(334,480)
Expenses			
Management fee to affiliate.....	3,942	5,937	4,544
Transaction costs	6,311	3,236	804
Financing fee.....	—	—	20,540
Other operating expenses	1,353	1,506	2,051
General and administrative expenses:			
Compensation expense	1,650	2,571	2,787
Professional fees	6,031	3,890	4,878
Other general and administrative expenses.....	2,523	3,508	3,303
Total general and administrative expenses.....	10,204	9,969	10,968
Total Expenses	21,810	20,648	38,907
Loss before income taxes	(85,295)	(49,766)	(327,950)
Income tax provision.....	171	99	396
Net loss	(85,466)	(49,865)	(328,346)
Net income (loss) attributable to non-controlling interest.....	3,613	(912)	8
Net loss attributable to common stockholders and participating securities....	\$ (89,079)	\$ (48,953)	\$ (328,354)
Net loss per Common Share — Basic ⁽¹⁾	\$ (14.77)	\$ (8.07)	\$ (57.20)
Net loss per Common Share — Diluted ⁽¹⁾	\$ (14.77)	\$ (8.07)	\$ (57.20)

(1) Amounts have been adjusted to reflect the one-for-ten reverse stock split effected July 11, 2022. See Note 2, “Basis of Presentation and Summary of Significant Accounting Policies” and Note 12, “Stockholders’ Equity” to the consolidated financial statements contained in this Annual Report on Form 10-K for additional details.

See notes to consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity
(in thousands—except shares and share data)

	Common Stock		Additional Paid-In Capital ⁽¹⁾	Retained	Treasury Stock	Total	Non-	Total
	Outstanding	Par		Earnings (Accumulated) Deficit		Stockholders' Equity	Controlling Interest	Equity
	Shares ⁽¹⁾							
Balance at December 31, 2019.....	5,352,390	\$ 53	\$ 889,709	\$ (325,301)	\$ —	\$ 564,461	\$ —	\$ 564,461
Net proceeds from public offerings of common stock.....	603,474	6	22,351	—	—	22,357	—	22,357
Offering costs	—	—	(371)	—	—	(371)	—	(371)
Proceeds from non-controlling interest, net of offering costs.....	—	—	—	—	—	—	2	2
Exchange of convertible senior notes	135,408	1	3,587	—	—	3,588	—	3,588
Vesting of restricted stock.....	—	—	699	—	—	699	—	699
Treasury stock	(10,000)	—	—	—	(578)	(578)	—	(578)
Net loss	—	—	—	(328,354)	—	(328,354)	8	(328,346)
Dividends declared on non-controlling interest.....	—	—	—	—	—	—	(8)	(8)
Dividends declared on common stock	—	—	32	(6,722)	—	(6,690)	—	(6,690)
Balance at December 31, 2020.....	6,081,272	60	916,007	(660,377)	(578)	255,112	2	255,114
Equity contributions	—	—	—	—	—	—	12,138	12,138
Equity component of convertible unsecured notes.....	—	—	2,060	—	—	2,060	—	2,060
Exchange of phantom stock for common stock	4,721	—	—	—	—	—	—	—
Offering costs	—	—	(70)	—	—	(70)	—	(70)
Vesting of restricted stock.....	—	—	619	—	—	619	—	619
Treasury stock	(47,981)	—	—	—	(1,087)	(1,087)	—	(1,087)
Net loss	—	—	—	(48,953)	—	(48,953)	(912)	(49,865)
Dividends declared on non-controlling interest.....	—	—	—	—	—	—	(8)	(8)
Dividends declared on common stock	—	—	79	(14,651)	—	(14,572)	—	(14,572)
Balance at December 31, 2021.....	6,038,012	60	918,695	(723,981)	(1,665)	193,109	11,220	204,329
Equity distributions	—	—	—	—	—	—	(14,817)	(14,817)
Vesting of restricted stock.....	—	—	435	—	—	435	—	435
Net loss	—	—	—	(89,079)	—	(89,079)	3,613	(85,466)
Dividends declared on non- controlling interest	—	—	—	—	—	—	(8)	(8)
Dividends declared on common stock	—	—	108	(9,769)	—	(9,661)	—	(9,661)
Balance at December 31, 2022.....	6,038,012	\$ 60	\$ 919,238	\$ (822,829)	\$ (1,665)	\$ 94,804	\$ 8	\$ 94,812

(1) Amounts have been adjusted to reflect the one-for-ten reverse stock split effected July 11, 2022. See Note 2, “Basis of Presentation and Summary of Significant Accounting Policies” and Note 12, “Stockholders' Equity” to the consolidated financial statements contained in this Annual Report on Form 10-K for additional details.

See notes to consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries
Consolidated Statements of Cash Flows
(in thousands)

For the year ended December 31,

	2022	2021	2020
Cash flows from operating activities:			
Net loss.....	\$ (85,466)	\$ (49,865)	\$ (328,346)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Premium amortization and (discount accretion), net.....	2,406	1,540	5,141
Interest income earned added to principal of investments	(96)	(485)	(829)
Amortization of deferred financing costs.....	2,525	5,445	3,577
Amortization of discount on convertible senior unsecured notes.....	820	944	1,097
Restricted stock amortization.....	435	618	699
Interest payments and basis recovered on MAC interest rate swaps.....	—	—	202
Premium on purchase of Residential Whole Loans.....	(6,619)	(17,058)	(3,858)
Financing fee.....	—	8,540	12,000
Unrealized loss, net.....	63,874	46,391	221,387
Unrealized (gain) loss on derivative instruments, net	(3,499)	208	3,953
Realized (gain) loss on exchange and extinguishment of convertible senior notes, net	(50)	1,509	(3,644)
Realized (gain) loss on sale of real estate owned (“REO”), net.....	(11,966)	(54)	789
Realized (gain) loss on investments, net	48,685	9,472	(81,416)
Loss on derivatives, net.....	1,762	—	13,134
Changes in operating assets and liabilities:			
Interest receivable	493	1,399	5,845
Invested related receivable	—	2,546	(2,544)
Other assets	(848)	339	(905)
Interest payable	2,522	(1,734)	(2,995)
Accounts payable and accrued expenses	(1,639)	2,095	(499)
Payable to affiliate.....	2,103	(1,246)	1,023
Other liabilities.....	50	(8,539)	8,541
Net cash provided by (used in) operating activities	<u>15,492</u>	<u>2,065</u>	<u>(147,648)</u>
Cash flows from investing activities:			
Purchase of securities.....	(39,952)	—	(320,996)
Proceeds from sale of securities	56,427	27,488	2,234,048
Principal repayments and basis recovered on securities.....	7,665	16,704	35,352
Proceeds from sale of REO	55,573	738	2,620
Purchase of Residential Whole Loans.....	(405,298)	(410,790)	(109,480)
Proceeds from sale of Residential Whole Loans.....	11,735	—	144,258
Principal repayments on Residential Whole Loans.....	233,486	411,605	288,568
Principal repayments on Commercial Loans.....	20,593	103,284	44,819
Principal repayments on securitized commercial loans.....	—	354,203	349,608
Principal repayments on Residential Bridge Loans.....	1,491	9,374	22,075
Premium for credit default swaps, net.....	(347)	—	(14,028)
Net settlements of TBAs	2,051	—	(2,430)
Proceeds from sale of interest rate swaptions.....	312	—	—
Due from counterparties, net.....	460	50	2,340
Interest payments and basis recovered on MAC interest rate swaps.....	—	—	(202)
Premium for interest rate swaptions, net.....	(473)	—	80
Net cash (used in) provided by investing activities.....	<u>(56,277)</u>	<u>512,656</u>	<u>2,676,632</u>
Cash flows from financing activities:			
Net proceeds from issuance of common stock.....	—	—	22,357
Payment of offering costs.....	(2)	(92)	(374)
Repurchase of common stock	—	(1,087)	(578)
Proceeds from repurchase agreement borrowings.....	3,519,541	4,592,689	10,020,593
Proceeds from convertible note offering	—	86,250	—
Payments on extinguishment of convertible senior notes	(37,555)	(136,754)	(21,975)
Proceeds from offering to non-controlling interest, net of offering costs	—	—	2

See notes to consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries
Consolidated Statements of Cash Flows (Continued)
(in thousands)

	For the year ended December 31,		
	2022	2021	2020
Repayments of repurchase agreement borrowings.....	(3,943,613)	(4,334,346)	(12,486,624)
Proceeds from securitized debt	742,432	—	460,787
Repayments of securitized debt.....	(234,337)	(683,472)	(579,705)
Financing fee.....	—	(8,540)	(12,000)
Payments made for deferred financing costs.....	—	(3,573)	(5,437)
Due from counterparties, net.....	(2,469)	(2,288)	94,280
Due to counterparties, net.....	300	(321)	(388)
Increase (decrease) in other liabilities, net	(12)	(75,873)	23,185
Equity distributions to non-controlling interest.....	(14,817)	—	—
Dividends paid on common stock	(10,869)	(14,598)	(19,633)
Dividends paid to non-controlling interest.....	(8)	(8)	(8)
Net cash provided by (used in) financing activities	<u>18,591</u>	<u>(582,013)</u>	<u>(2,505,518)</u>
Net (decrease) increase in cash and cash equivalents.....	(22,194)	(67,292)	23,466
Cash, cash equivalents and restricted cash, beginning of period.....	40,453	107,745	84,279
Cash, cash equivalents and restricted cash, end of period.....	<u>\$ 18,259</u>	<u>\$ 40,453</u>	<u>\$ 107,745</u>
Supplemental disclosure of operating cash flow information:			
Interest paid.....	<u>\$ 107,510</u>	<u>\$ 110,707</u>	<u>\$ 119,957</u>
Income taxes paid.....	<u>\$ 50</u>	<u>\$ 192</u>	<u>\$ 810</u>
Supplemental disclosure of non-cash financing/investing activities:			
Underwriting and offering costs payable	<u>\$ —</u>	<u>\$ 2</u>	<u>\$ —</u>
Principal payments of securities, not settled	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 44</u>
Assets of deconsolidated VIE	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (150,804)</u>
Liabilities of deconsolidated VIE.....	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 143,952</u>
Mortgage-backed securities recorded upon deconsolidation.....	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 6,852</u>
Assets of consolidated VIE	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,245,287</u>
Liabilities of consolidated VIE	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (1,231,549)</u>
Mortgage-backed securities derecognized upon VIE consolidation.....	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (13,737)</u>
Dividends and distributions declared, not paid	<u>\$ 2,415</u>	<u>\$ 3,623</u>	<u>\$ 3,649</u>
Principal payments of Residential Whole Loans, not settled	<u>\$ 4,619</u>	<u>\$ 21,970</u>	<u>\$ 26,885</u>
Principal payments of Residential Bridge Loans, not settled.....	<u>\$ 1,341</u>	<u>\$ 163</u>	<u>\$ 1,102</u>
Other assets - Transfer of Residential Whole Loans to REO	<u>\$ 2,255</u>	<u>\$ —</u>	<u>\$ —</u>
Other assets - Transfer of Residential Bridge Loans to REO.....	<u>\$ —</u>	<u>\$ 752</u>	<u>\$ 419</u>
Other assets - Transfer of Commercial Loans to REO.....	<u>\$ —</u>	<u>\$ 30,345</u>	<u>\$ —</u>
Other assets - Transfer of REO from non-controlling interest	<u>\$ —</u>	<u>\$ 12,138</u>	<u>\$ —</u>
Financing fee payable	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (8,540)</u>
Exchange of convertible senior notes for commons stock	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,588</u>
Reconciliation of cash, cash equivalents and restricted cash reported in the Consolidated Balance Sheets:			
Cash and cash equivalents.....	<u>\$ 18,011</u>	<u>\$ 40,193</u>	<u>\$ 31,613</u>
Restricted cash	<u>248</u>	<u>260</u>	<u>76,132</u>
Total cash, cash equivalents and restricted cash shown in the Consolidated Statements of Cash Flows.....	<u>\$ 18,259</u>	<u>\$ 40,453</u>	<u>\$ 107,745</u>

See notes to consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries

Notes to Consolidated Financial Statements (in thousands—except share and per share data)

The following defines certain of the commonly used terms in these Notes to Consolidated Financial Statements: “Agency” or “Agencies” refer to a federally chartered corporation, such as the Federal National Mortgage Association (“Fannie Mae” or “FNMA”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac” or “FHLMC”), or an agency of the U.S. Government, such as the Government National Mortgage Association (“Ginnie Mae” or “GNMA”); references to “MBS” refer to mortgage backed securities, including residential mortgage-backed securities or “RMBS,” commercial mortgage-backed securities or “CMBS,” and “Interest-Only Strips” (as defined herein); “Agency MBS” refer to RMBS, CMBS and Interest-Only Strips issued or guaranteed by the Agencies while “Non-Agency MBS” refer to RMBS, CMBS and Interest-Only Strips that are not issued or guaranteed by the Agencies; references to “ARMs” refers to adjustable rate mortgages; references to “Interest-Only Strips” refer to interest-only (“IO”) and inverse interest-only (“IO”) securities issued as part of or collateralized with MBS; references to “TBA” refer to To-Be-Announced Securities; and references to “Residential Whole Loans,” “Residential Bridge Loans” and “Commercial Loans” (collectively “Whole Loans”) refer to individual mortgage loans secured by single family, multifamily and commercial properties.

Note 1—Organization

Western Asset Mortgage Capital Corporation, a Delaware corporation, and its subsidiaries (the “Company”), commenced operations in May 2012. The Company invests in, finances, and manages a portfolio of real estate related securities, Whole Loans, and other financial assets. The Company’s current portfolio is comprised of Non-Qualified (“Non-QM”) Residential Whole Loans, Non-Agency RMBS, Commercial Loans, Non-Agency CMBS, and to a lesser extent Agency RMBS, GSE Risk Transfer Securities, Residential Bridge Loans, and asset-backed securities (“ABS”) secured by a portfolio of private student loans. The Company’s investment strategy is based on Western Asset Management Company, LLC’s (the “Manager”) perspective of which mix of portfolio assets it believes provides the Company with the best risk-reward opportunities at any given time. The Company’s current investment strategy will focus on residential real estate related investments, including but not limited to non-qualified mortgage loans, Non-agency RMBS, and other related investments. The Manager will vary the allocation among these asset classes subject to maintaining the Company’s qualification as a REIT and maintaining its exemption from the Investment Company Act of 1940, as amended (the “1940 Act”). These restrictions limit the Company’s ability to invest in non-qualified MBS, non-real estate assets, and/or assets which are not secured by real estate. Accordingly, the Company’s portfolio will continue to be principally invested in qualifying MBS, Whole Loans, and other real estate related assets.

The Company is externally managed by the Manager, an investment advisor registered with the Securities and Exchange Commission (“SEC”). The Manager is a wholly-owned subsidiary of Franklin Resources, Inc. (“Franklin”). The Company operates and has elected to be taxed as a real estate investment trust or “REIT” commencing with its taxable year ended December 31, 2012.

During the second quarter of 2022, the Company announced that its Board of Directors had authorized a review of strategic alternatives for the Company aimed at enhancing shareholder value, which may include a sale or merger of the Company. JMP Securities, A Citizens Company, has been retained as exclusive financial advisor to the Company. No assurance can be given that the review being undertaken will result in a sale, merger, or other transaction involving the Company, and the Company has not set a timetable for completion of the review process. The current market environment for mortgage REITs remains challenging, given the rapid rise in interest rates and the increased potential for an economic retrenchment, which has added complexity to our exploration of strategic partners. The Company does not intend to make any further statements regarding this process unless and until a definitive agreement for a transaction has been reached, or until the process of exploring strategic alternatives has ended.

Note 2—Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The accompanying financial statements and related notes have been prepared in conformity with generally accepted accounting principles in the United States of America (“GAAP”). The consolidated financial statements include the accounts of the Company, its wholly-owned and majority owned subsidiaries and VIEs in which it is considered the primary beneficiary. All intercompany amounts between the Company and its subsidiaries and consolidated VIEs have been eliminated in consolidation.

Reverse Stock Split

Our amended and restated certificate of incorporation as of June 30, 2022, authorizes the Company to issue a total of 600,000,000 shares of capital stock, consisting of 500,000,000 shares of common stock, par value \$0.01 per share, and 100,000,000 shares of preferred stock, par value \$0.01 per share.

Following approval by the Company’s stockholders of a reverse stock split between a range of 1-for-5 and 1-for-10 of currently outstanding shares of the Company’s common stock, on June 30, 2022, the Company’s board of directors selected a one-for-ten reverse stock split ratio. The one-for-ten reverse stock split was effected on July 11, 2022, which reduced the total number of authorized shares of common stock from 500,000,000 to 50,000,000 and the total number of issued and outstanding shares from 60,380,105 to 6,038,012. The par value per share of our common stock remained unchanged at \$0.01. All per share amounts and common shares outstanding have been adjusted on a retroactive basis to reflect the Company’s one-for-ten reverse stock split.

Our stockholders' equity, in the aggregate, remains unchanged. Per share net income or loss increased because there are fewer shares of common stock outstanding. The common stock held in treasury was reduced in proportion to the reverse stock split ratio. There were no other accounting consequences, including changes to the amount of stock-based compensation expense to be recognized in any period, that arose as a result of the reverse stock split. No fractional shares were issued in connection with the reverse stock split. Instead, each stockholder holding fractional shares was entitled to receive, in lieu of such fractional shares, cash in an amount determined based on the closing price of the Company's common stock the business day prior to the effective date. The reverse stock split applied to all of the Company's outstanding shares of common stock and did not affect any stockholder's ownership percentage of shares of the Company's common stock, except for immaterial changes resulting from the payment of cash for fractional shares.

Variable Interest Entities

VIEs are defined as entities that by design either lack sufficient equity for the entity to finance its activities without additional subordinated financial support or are unable to direct the entity's activities or are not exposed to the entity's losses or entitled to its residual returns. The Company evaluates all of its interests in VIEs for consolidation. When the interests are determined to be variable interests, the Company assesses whether it is deemed the primary beneficiary. The primary beneficiary of a VIE is determined to be the party that has both the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE.

To assess whether the Company has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, it considers all facts and circumstances, including its role in establishing the VIE and its ongoing rights and responsibilities. This assessment includes: first, identifying the activities that most significantly impact the VIE's economic performance; and second, identifying which party, if any, has power over those activities. In general, the parties that make the most significant decisions affecting the VIE or have the right to unilaterally remove those decision makers are deemed to have the power to direct the activities of a VIE.

To assess whether the Company has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, it considers all of its economic interests. This assessment requires the Company to apply judgment in determining whether these interests, in the aggregate, are considered potentially significant to the VIE. Factors considered in assessing significance include; the design of the VIE, including its capitalization structure, subordination of interests, payment priority, relative share of interests held across various classes within the VIE's capital structure, and the reasons why the interests are held by the Company.

In instances where the Company and its related parties have variable interests in a VIE, the Company considers whether there is a single party in the related party group that meets both the power and losses or benefits criteria on its own as though no related party relationship existed. If one party within the related party group meets both these criteria, such reporting entity is the primary beneficiary of the VIE and no further analysis is needed. If no party within the related party group on its own meets both the power and losses or benefits criteria, but the related party group as a whole meets these two criteria, the determination of primary beneficiary within the related party group requires significant judgment. The analysis is based upon qualitative as well as quantitative factors, such as the relationship of the VIE to each of the members of the related-party group, as well as the significance of the VIE's activities to those members, with the objective of determining which party is most closely associated with the VIE. Ongoing assessments of whether an enterprise is the primary beneficiary of a VIE are required.

Use of Estimates

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Earnings (Loss) Per Share

GAAP requires use of the two-class method in computing earnings per share for all periods presented for each class of common stock and participating securities as if all earnings for the period had been distributed. Under the two-class method, during periods of net income, the net income is first reduced for dividends declared on all classes of securities to arrive at undistributed earnings. During periods of net losses, the net loss is reduced for dividends declared on participating securities only if the security has the right to participate in the earnings of the entity and an objectively determinable contractual obligation to share in net losses of the entity. The Company's participating securities are not allocated a share of the net loss, as the participating securities do not have a contractual obligation to share in the net losses of the Company.

The remaining earnings are allocated to common stockholders and participating securities, to the extent that each security shares in earnings, as if all of the earnings for the period had been distributed. Each total is then divided by the applicable number of weighted average outstanding common shares to arrive at basic earnings per share. For the diluted earnings, the denominator includes the weighted average outstanding common shares and all potential common shares assumed issued if they are dilutive. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of these potential common shares.

Offering Costs

Offering costs borne by the Company in connection with common stock offerings and private placements are reflected as a reduction of additional paid-in-capital. Offering costs borne by the Company in connection with its shelf registration will be deferred and recorded in “Other assets” until such time the Company completes a common stock offering where all or a portion will be reclassified and reflected as a reduction of additional paid-in-capital. The deferred offering costs will be expensed upon the expiration of the shelf if the Company does not complete an equity offering.

Cash and Cash Equivalents

The Company considers all highly liquid short-term investments with original maturities of 90 days or less when purchased to be cash equivalents. Cash and cash equivalents are exposed to concentrations of credit risk. The Company places its cash and cash equivalents with what it believes to be high credit quality institutions. At times such investments may be in excess of the Federal Deposit Insurance Corporation insurance limit.

Restricted Cash

Restricted cash represents cash held by the trustee or servicer for mortgage escrows in connection with the Company’s securitized loan and commercial loan investments held in its consolidated VIEs. These escrows consist of principal and interest escrows, capital improvement reserves, repair reserves, real estate tax and insurance reserves and tenant reserves. The corresponding liability is recorded in “Other liabilities” in the Consolidated Balance Sheets. The restricted cash is not available for general corporate use.

Valuation of Financial Instruments

The Company discloses the fair value of its financial instruments according to a fair value hierarchy (Levels I, II, and III, as defined below). ASC 820, “Fair Value Measurement and Disclosures” establishes a framework for measuring fair value and expands financial statement disclosure requirements for fair value measurements. ASC 820 further specifies a hierarchy of valuation techniques, which is based on whether the inputs into the valuation technique are observable or unobservable. The hierarchy is as follows:

Level I — Quoted prices in active markets for identical assets or liabilities.

Level II — Quoted prices for similar assets and liabilities 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.

Level III — Prices are determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable, for example, when there is little or no market activity for an investment at the end of the period, unobservable inputs may be used.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Transfers between levels are determined by the Company at the end of the reporting period. Refer to Note 3, “Fair Value of Financial Instruments” to the financial statements contained in this annual report on Form 10-K.

Mortgage-Backed Securities and Other Securities

The Company’s mortgage-backed securities and other securities portfolio primarily consisted of Agency CMBS, Non-Agency CMBS, Agency RMBS, Non-Agency RMBS, ABS and other real estate related securities. These investments are recorded in accordance with ASC 320, “Investments - Debt and Equity Securities” and ASC 325-40, “Beneficial Interests in Securitized Financial Assets”. The Company has chosen to elect the fair value option pursuant to ASC 825, “Financial Instruments” for its mortgage-backed securities and other securities portfolio. Electing the fair value option allows the Company to record changes in fair value in the Consolidated Statements of Operations as a component of “Unrealized loss, net”.

Residential Whole Loans

Investments in Residential Whole Loans are recorded in accordance with ASC 310, “Receivables”. The Company has chosen to elect the fair value option pursuant to ASC 825 for our entire Residential Whole-Loan portfolio. Residential Whole Loans are recorded at fair value with periodic changes in fair market value being recorded in earnings as a component of “Unrealized loss, net”. All other costs incurred in connection with acquiring Residential Whole Loans or committing to purchase these loans are charged to expense as incurred.

Residential Bridge Loans

For the Bridge Loans acquired prior to October 25, 2017, the Company did not elect the fair value option pursuant to ASC 825. These loans are recorded at their principal amount outstanding, net of any premium or discount. Commencing with purchases on October 25, 2017, the Company decided to elect the fair value option pursuant to ASC 825 to be consistent with the accounting of its’ other investments, which are all carried at fair value. These loans are recorded at fair value with periodic changes in fair market value being recorded in earnings as a component of “Unrealized loss, net.” All other costs incurred in connection with acquiring the Residential Bridge Loans or committing to purchase these loans are charged to expense as incurred. All remaining bridge loans as of December 31, 2022 were purchased subsequent to October 25, 2017 and are accounted for at fair value.

Securitized Commercial Loans

Securitized commercial loans are comprised of commercial loans of consolidated variable interest entities which were sponsored by third parties. These loans are recorded in accordance with ASC 310-20, "Nonrefundable Fees and Other Costs". The Company has chosen to elect the fair value option pursuant to ASC 825. Accordingly, these loans are recorded at fair value with periodic changes in fair value being recorded in earnings as a component of "Unrealized loss, net".

Commercial Loans

Investments in Commercial Loans, which are comprised of first lien commercial mortgage loans and commercial mezzanine loans, are recorded in accordance with ASC 310-20, "Nonrefundable Fees and Other Costs". The Company has chosen to make the fair value election pursuant to ASC 825 for its Commercial Loan portfolio. Accordingly, these loans are recorded at fair value with periodic changes in fair value being recorded in earnings as a component of "Unrealized loss, net". All other costs incurred in connection with acquiring the Commercial Loans or committing to purchase these loans are charged to expense as incurred.

Credit Loss on Investments

The Company's loan investments are typically collateralized by real estate. As a result, the Company regularly evaluates the extent and impact of any credit migration associated with the performance and or value of the underlying collateral property as well as the financial and operating capability of the borrower on a loan by loan basis. On a quarterly basis, the Company evaluates the collectability of both interest and principal of each loan, if circumstances warrant, to determine whether such loan is impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the existing contractual terms.

The Company elected the Fair Value Option for all of its investments and accordingly it does not apply the expected loss model in accordance with ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("CECL")" instead the Company records changes in fair value of these investment in the Consolidated Statements of Operations as a component of "Unrealized loss, net".

Real Estate Owned

REO represents real estate property acquired by the Company through foreclosure and it is classified as held for sale. Upon completion of the foreclosure, the Company initially records the REO at fair value less estimated costs to sell the property. In subsequent periods, REO is reported at the lower of the current carrying amount or fair value less estimated selling costs and it is classified in "Other assets" in the Consolidated Balance Sheets. Gains/losses recognized on foreclosure as well as realized gains/losses on the disposition of REO are reported by the Company in "Realized gain (loss), net" in the Consolidated Statements of Operations.

Interest Income Recognition

Agency MBS, Non-Agency MBS and other securities, excluding Interest-Only Strips, rated AA and higher at the time of purchase

Interest income on mortgage-backed and other securities is accrued based on the respective outstanding principal balances and corresponding contractual terms. The Company records interest income in accordance with ASC subtopic 310-20 "Receivables - Nonrefundable Fees and Other Costs", using the effective interest method. As such premiums and discounts associated with Agency MBS, Non-Agency MBS and other securities, excluding Interest-Only Strips, are amortized into interest income over the estimated life of such securities. Adjustments to premium and discount amortization are made for actual prepayment activity. The Company estimates prepayments at least quarterly for its securities and, as a result, if the projected prepayment speed increases, the Company will accelerate the rate of amortization on premiums or discounts and make a retrospective adjustment to historical amortization. Alternatively, if projected prepayment speeds decrease, the Company will reduce the rate of amortization on the premiums or discounts and make a retrospective adjustment to historical amortization.

Non-Agency MBS and other securities that are rated below AA at the time of purchase and Interest-Only Strips that are not classified as derivatives

Interest income on Non-Agency MBS and other securities that are rated below AA at the time of purchase and Interest-Only Strips that are not classified as derivatives are also recognized in accordance with ASC 835, using the effective yield method. The effective yield on these securities is based on the projected cash flows from each security, which is estimated based on the Company's observation of the then current information and events, where applicable, and will include assumptions related to interest rates, prepayment rates and the timing and amount of credit losses. On at least a quarterly basis, the Company reviews and, if appropriate, makes adjustments to its cash flow projections based on input and analysis received from external sources, internal models, and its judgment about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in the yield/interest income recognized on such securities. Actual maturities of the securities are affected by the contractual lives of the underlying collateral, periodic payments of scheduled principal, and prepayments of principal. Therefore, actual maturities of the securities will generally be shorter than stated contractual maturities.

Loan Portfolio

Interest income on the Company's residential loan portfolio and commercial loan portfolio is recorded using the effective interest method based on the contractual payment terms of the loan. Any premium amortization or discount accretion will be reflected as a component of "Interest income" in the Consolidated Statements of Operations.

Income recognition is suspended for loans at the earlier of the date at which payments become 90-days past due or when, in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, contractual interest is recorded as interest income when received, under the cash basis method until an accrual is resumed when the loan becomes contractually current and performance is demonstrated.

Investment Related Receivables

The Company accounts for mortgage payments received from borrowers after the date of record of the trustee and/or recordkeeper but prior to period end as an Investment Related Receivable on the Balance Sheet in accordance with ASC 310, "Receivables." This balance is calculated based on subsequent month servicer and trustee reports and represents actual cash received prior to the date of record. Principal on each loan paid in accordance with this fact pattern is decreased when the amount of cash received prior to period end is known to the Company.

Purchases and Sales of Investments

The Company accounts for a contract for the purchase or sale of securities, or other securities that do not yet exist on a trade date basis, which it intends to take possession and thus recognizes the acquisition or disposition of the securities at the inception of the contract.

Sales of investments are driven by the Company's portfolio management process. The Company seeks to mitigate risks including those associated with prepayments and will opportunistically rotate the portfolio into securities and/or other investments the Company's Manager believes have more favorable attributes. Strategies may also be employed to manage net capital gains, which need to be distributed for tax purposes. Realized gains or losses on sales of investments, including Agency Interest-Only Strips not characterized as derivatives, are a component of "Realized gain (loss) on sale of investments, net" in the Consolidated Statements of Operations, and are recorded at the time of disposition. Realized gains or losses on Interest-Only Strips which are characterized as derivatives are a component of "Gain (loss) on derivative instruments, net" in the Consolidated Statements of Operations.

Due From Counterparties / Due To Counterparties

"Due from counterparties" represents cash posted by the Company with its counterparties as collateral for the Company's interest rate and/or futures contracts, repurchase agreements, and TBAs. "Due to counterparties" represents cash posted with the Company by its counterparties as collateral under the Company's interest rate and/or currency derivative financial instruments, repurchase agreements, and TBAs. Included in "Due from counterparties" and/or "Due to counterparties" are daily variation margin settlement amounts with counterparties which are based on the price movement of the Company's futures contracts. Daily variation margin on only the Company's centrally cleared derivatives was treated as a settlement and classified as either "Derivative assets, at fair value" or "Derivative liability, at fair value" in the Consolidated Balance Sheets. In addition, as provided below, "Due to counterparties" may include non-cash collateral in which the Company has the obligation to return and which the Company has either sold or pledged. To the extent the Company receives collateral other than cash from its counterparties, such assets are not included in the Company's Consolidated Balance Sheets. Notwithstanding the foregoing, if the Company either rehypothecates such assets or pledges the assets as collateral pursuant to a repurchase agreement, the cash received and the corresponding liability are reflected in the Consolidated Balance Sheets.

Derivatives and Hedging Activities

Subject to maintaining its qualification as a REIT for U.S. federal income tax purposes, the Company as part of its hedging strategy, we may enter into interest rate swaps, including forward starting swaps, interest rate swaptions, U.S. Treasury options, Eurodollar, Volatility Index and U.S. Treasury futures, TBAs, total return swaps, credit default swaps and forwards to hedge the interest rate and currency risk associated with its portfolio and related borrowings. Derivatives, subject to REIT requirements, are used for hedging purposes rather than speculation. The Company determines the fair value of its derivative positions and obtains quotations from third parties, including the Chicago Mercantile Exchange or CME, to facilitate the process of determining such fair values. The Company does not necessarily seek to hedge all such risks. In addition, if the Company's hedging activities do not achieve the desired results, reported earnings may be adversely affected.

GAAP requires an entity to recognize all derivatives as either assets or liabilities on the balance sheet and to measure those instruments at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative. The fair value adjustment will affect either other comprehensive income in stockholders' equity until the hedged item is recognized in earnings or net income depending on whether the derivative instrument is designated and qualifies as a hedge for accounting purposes and if so, the nature of the hedging activity. The Company elected not to apply hedge accounting for its derivative instruments. Accordingly, the Company records the change in fair value of its derivative instruments, which includes net interest rate swap payments/receipts (including accrued amounts) and net currency payments/receipts (including accrued amounts) related to interest rate swaps and currency swaps, respectively, in "Gain (loss) on derivative instruments, net" in its Consolidated Statements of Operations.

The Company accounts for variation margins as partial settlement of the respective derivative asset or liability that will result in realized gains or losses on the derivative contract in the Consolidated Statement of Operation. The cash payments for variation margin are included in operating activities in the Consolidated Statements of Cash Flows.

In the Company's Consolidated Statements of Cash Flows, premiums received or paid on termination of its interest rate swaps are included in cash flows from operating activities. Notwithstanding the foregoing, proceeds and payments on settlement of swaptions, futures contracts and TBAs are included in cash flows from investing activities. Proceeds and payments on settlement of forward contracts are reflected in cash flows from financing activities in the Company's Consolidated Statements of Cash Flows. For Agency and Non-Agency Interest-Only Strips accounted for as derivatives, the purchase, sale and recovery of basis activity is included with MBS and other securities under cash flows from investing activities in the Company's Consolidated Statements of Cash Flows.

The Company evaluates the terms and conditions of its holdings of Agency and Non-Agency Interest-Only Strips, interest rate swaptions, currency forwards, futures contracts and TBAs to determine if these instruments have the characteristics of an investment or should be considered a derivative under GAAP. In determining the classification of its holdings of Interest-Only Strips, the Company evaluates the securities to determine if the nature of the cash flows have been altered from that of the underlying mortgage collateral. Interest-Only Strips, for which the underlying mortgage collateral has been included into a structured security that alters the cash flows from the underlying mortgage collateral, are accounted for as derivatives. The carrying value of the Agency and Non-Agency Interest-Only Strips, accounted for as derivatives, is included in "Mortgage-backed securities and other securities, at fair value" in the Consolidated Balance Sheets. The carrying value of interest rate swaptions, currency forwards, futures contracts and TBAs is included in "Derivative assets, at fair value" or "Derivative liability, at fair value" in the Consolidated Balance Sheets. Interest earned or paid along with the change in fair value of these instruments accounted for as derivatives is recorded in "Gain (loss) on derivative instruments, net" in its Consolidated Statements of Operations.

The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. An embedded derivative is separated from the host contract and accounted for separately when all of the guidance criteria are met. Hybrid instruments that are remeasured at fair value through earnings, including the fair value option are not bifurcated. Derivative instruments, including derivative instruments accounted for as liabilities, are recorded at fair value and are re-valued at each reporting date, with changes in the fair value together with interest earned or paid (including accrued amounts) reported in "Gain (loss) on derivative instruments, net" in the Consolidated Statements of Operations.

Repurchase Agreements and Reverse Repurchase Agreements

Investments sold under repurchase agreements are treated as collateralized financing transactions, unless they meet all the criteria for sales treatment. Securities financed through a repurchase agreement remain in the Company's Consolidated Balance Sheets as assets and cash received from the lender is recorded in the Company's Consolidated Balance Sheets as a liability. Interest payable in accordance with repurchase agreements is recorded as "Accrued interest payable" in the Consolidated Balance Sheets. Interest paid (including accrued amounts) in accordance with repurchase agreements is recorded as interest expense.

The Company may borrow securities under reverse repurchase agreements to deliver a security owned and sold by the Company but pledged to a different counterparty under a separate repurchase agreement when in the Manager's view terminating the outstanding repurchase agreement is not in the Company's best interest. Cash paid to the borrower is recorded in the Company's Consolidated Balance Sheets as an asset. Interest receivable in accordance with reverse repurchase agreements is recorded as accrued interest receivable in the Consolidated Balance Sheets. The Company reflects all proceeds on reverse repurchase agreement and repayment of reverse repurchase agreement, on a net basis in the Consolidated Statements of Cash Flows. Upon sale of a pledged security, the Company recognizes an obligation to return the borrowed security in the Consolidated Balance Sheet in "Due to counterparties." The Company establishes haircuts to ensure the market value of the underlying asset remains sufficient to protect the Company in the event of default by the counterparty. Realized gains and losses associated with the sale of the security are recognized as an adjustment to Net income (loss) in "Realized gain (loss) on investments, net" in the Consolidated Statements of Cash Flows.

Securitized Debt Issued

Securitized debt issued represents Non-QM mortgage-backed securities issued through the Arroyo 2019-2, 2020-1, 2022-1, and 2022-2 securitization entities. Assets at these entities are held in the custody of securitization trustees and are not owned by the Company. These trustees collect principal and interest payments (less servicing and related fees) from the assets and make corresponding principal and interest payments to the securitized debt investors. In accordance with accounting guidance for CFEs (ASC 825), we account for the securitized debt issued under Arroyo 2022-1 and Arroyo 2022-2 at fair value, with periodic changes in fair value recorded in "Unrealized gain (loss), net" on our consolidated statements of income (loss). We account for the securitized debt issued under Arroyo 2019-2 and Arroyo 2020-1 at amortized cost. The Company did not elect the fair value option for these notes and accordingly they are recorded at their principal balance less unamortized deferred financing costs and classified in "Securitized debt, net" in the Consolidated Balance Sheets.

Convertible Senior Unsecured Notes

Convertible senior unsecured notes include unsecured convertible debt that is carried at its unpaid principal balance, net of any unamortized deferred issuance costs, in the Company's Consolidated Balance Sheets. Interest on the notes is payable semiannually until such time the notes mature or are converted into shares of the Company's common stock. ASC 470-20 "Debt-Debt with Conversion and Other Options" requires that convertible debt instruments with cash settlement features, including partial cash settlement, account for the liability component and equity component (conversion feature) of the instrument separately. The initial value of the liability component will reflect the present value of the discounted cash flows using the nonconvertible debt borrowing rate at the time of issuance. The debt discount represents the difference between the proceeds received from the issuance and the initial carrying value of the liability component, which is accreted back to the notes principal amount through interest expense over the life of the notes.

Share-based Compensation

Compensation cost related to restricted common stock or restricted stock units ("RSUs") issued to the Company's independent directors, is measured at its fair value at the grant date and amortized into expense over the service period on a straight-line basis. Compensation cost related to restricted common stock issued to the Manager and to employees of the Manager, including officers and certain directors, of the Company who are employees of the Manager and its affiliates, is initially measured at fair value at the grant date, and amortized into expense over the vesting period on a straight-line basis.

Income Taxes

The Company operates and has elected to be taxed as a REIT commencing with its taxable year ended December 31, 2012. Accordingly, the Company will generally not be subject to corporate U.S. federal or state income tax to the extent that the Company makes qualifying distributions to stockholders, and provided that 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, the Company 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 failure to qualify as a REIT could have a material adverse impact in the Company's results of operations and amounts available for distribution to stockholders.

As a REIT, if the Company fails to distribute in any calendar year (subject to specific timing rules for certain dividends paid in January) at least the sum of (i) 85% of its ordinary income for such year, (ii) 95% of its capital gain net income for such year, and (iii) any undistributed taxable income from the prior year, the Company would be subject to a non-deductible 4% excise tax on the excess of such required distribution over the sum of (i) the amounts actually distributed and (ii) the amounts of income retained and on which the Company has paid corporate income tax.

The dividends paid deduction for qualifying dividends paid to stockholders is computed using the Company's taxable income as opposed to net income reported in the Consolidated Statements of Operations. Taxable income, generally, will differ from net income reported in the Consolidated Statements of Operations because the determination of taxable income is based on tax regulations and not GAAP.

From time to time the Company may create and elect to treat certain 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 domestic TRS is subject to U.S. federal, state and local corporate income taxes, and its value, along with all other TRS's, may not exceed 20% of the value of the Company. If the TRS generates net income it may declare dividends to the Company, which will be included in the Company's taxable income and necessitate a distribution to its stockholders. Conversely, if the Company retains earnings at the TRS level, no distribution is required and it can increase book equity of the consolidated entity. As of December 31, 2022, the Company has a single wholly-owned subsidiary which it has elected to treat as a domestic TRS.

Current and deferred taxes are recorded on earnings (losses) recognized by the Company's TRS. Deferred income tax assets and liabilities are calculated based upon temporary differences between the Company's U.S. GAAP consolidated financial statements and the federal and state basis of assets and liabilities as of the Consolidated Balance Sheet date. The Company evaluates the realizability of its deferred tax assets and recognizes a valuation allowance if, based on available evidence, it is more likely than not that some or all of its deferred tax assets will not be realized. In evaluating the realizability of the deferred tax asset, the Company will consider the expected future taxable income, existing and projected book to tax differences as well as tax planning strategies. This analysis is inherently subjective, as it is based on forecasted earning and business and economic activity. Changes in estimates of deferred tax asset realizability, if any, are included in "Income tax provision" in the Consolidated Statements of Operations.

Comprehensive Income (Loss)

The Company has none of the components of comprehensive income (loss) and therefore comprehensive income (loss) is not presented.

Recently adopted accounting pronouncements

Description	Effective Date	Effect on Financial Statements
In August 2020, the FASB issued ASU 2020-06, "Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging— Contracts in Entity's Own Equity (Subtopic 815-40)." The amendments in this Update affect entities that issue convertible instruments and/or contracts in an entity's own equity. For convertible instruments, the instruments primarily affected are those issued with beneficial conversion features or cash conversion features because the accounting models for those specific features are removed.	January 1, 2024	The Company evaluated the impact this standard may have on its consolidated financial statements and does not believe it will have a material impact on its financial statements and disclosures due to the limited nature of such transactions.
In March 2021, the FCA announced that the intended cessation date of the overnight 1-, 3-, 6-, and 12-month tenors of USD LIBOR would be June 30, 2023, which was beyond the current sunset date of Topic 848. Accordingly, during December 2022, the FASB issued ASU 2022-06 to defer the sunset date of ASC Topic 848, Reference Rate Reform, which provides temporary optional relief in accounting for the impact of reference rate reform from December 31, 2022, to December 31, 2024, after which entities will no longer be permitted to apply the relief in Topic 848. The amendments apply to all entities that have contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform.	March 12, 2020 through December 31, 2024	With additional time granted to apply the relief in Topic 848 extended through December 31, 2024, Management will monitor legacy LIBOR reference rate contracts outstanding as of December 31, 2022 in the investment portfolio, as either they will terminate prior to the June 30, 2023 LIBOR cessation date currently set by the FCA, or the Company will use the practical expedients per Topic 848 to account for modifications to contracts prospectively within the scope of Topics 310, Receivables, and 470, Debt, as a continuation of the existing contracts, as long as no modifications effecting maturity or other terms are modified. The Company will adjust the effective interest rate of all contracts, hedging relationships, and other transactions that reference LIBOR to revised reference rates and spreads as they occur. The variable- and floating-rate note sectors have primarily transitioned away from LIBOR as the market has already adapted to the secured overnight financing rate (SOFR), as the primary index used by issuers. The Company believes this will not have a material impact on its financial statements and disclosures.

Note 3—Fair Value of Financial Instruments

The following tables present the Company's financial instruments carried at fair value as of December 31, 2022 and December 31, 2021, based upon the valuation hierarchy (dollars in thousands):

	December 31, 2022			
	Fair Value			
	Level I	Level II	Level III	Total
Assets				
Agency RMBS Interest-Only Strips.....	\$ —	\$ —	\$ 53	\$ 53
Agency RMBS Interest-Only Strips accounted for as derivatives, included in MBS.....	—	—	714	714
Subtotal Agency MBS.....	—	—	767	767
Non-Agency CMBS	—	85,435	—	85,435
Non-Agency RMBS	—	22,483	—	22,483
Non-Agency RMBS Interest-Only Strips.....	—	—	1,204	1,204
Subtotal Non-Agency MBS	—	107,918	1,204	109,122
Other Securities.....	—	27,262	—	27,262
Total Mortgage-backed Securities and Other Securities	—	135,180	1,971	137,151
Residential Whole Loans	—	—	1,091,145	1,091,145
Residential Bridge Loans	—	—	2,849	2,849
Commercial Loans	—	—	90,002	90,002
Securitized Commercial Loan.....	—	—	1,085,103	1,085,103
Derivative Assets	—	1	—	1
Total Assets.....	\$ —	\$ 135,181	\$ 2,271,070	\$ 2,406,251
Liabilities				
Derivative Liabilities.....	\$ —	\$ 61	\$ —	\$ 61
Securitized Debt.....	—	1,710,938	8,927	1,719,865
Total Liabilities	\$ —	\$ 1,710,999	\$ 8,927	\$ 1,719,926

December 31, 2021

	Fair Value			
	Level I	Level II	Level III	Total
Assets				
Agency RMBS Interest-Only Strips.....	\$ —	\$ —	\$ 114	\$ 114
Agency RMBS Interest-Only Strips accounted for as derivatives, included in MBS.....	—	—	1,058	1,058
Subtotal Agency MBS.....	—	—	1,172	1,172
Non-Agency CMBS.....	—	99,630	5,728	105,358
Non-Agency RMBS.....	—	25,652	—	25,652
Non-Agency RMBS Interest-Only Strips.....	—	—	2,117	2,117
Subtotal Non-Agency MBS.....	—	125,282	7,845	133,127
Other securities.....	—	51,648	—	51,648
Total mortgage-backed securities and other securities.....	—	176,930	9,017	185,947
Residential Whole Loans.....	—	—	1,023,502	1,023,502
Residential Bridge Loans.....	—	—	5,428	5,428
Commercial Loans.....	—	—	130,572	130,572
Securitized Commercial loan.....	—	—	1,355,808	1,355,808
Derivative assets.....	—	105	—	105
Total Assets.....	<u>\$ —</u>	<u>\$ 177,035</u>	<u>\$ 2,524,327</u>	<u>\$ 2,701,362</u>
Liabilities				
Derivative liabilities.....	\$ —	\$ 602	\$ —	\$ 602
Securitized debt.....	—	1,329,451	14,919	1,344,370
Total Liabilities.....	<u>\$ —</u>	<u>\$ 1,330,053</u>	<u>\$ 14,919</u>	<u>\$ 1,344,972</u>

When available, the Company uses quoted market prices to determine the fair value of an asset or liability. If quoted market prices are not available, the Company will use independent pricing services and if the independent pricing service cannot price a particular asset or liability, the Company will obtain third party broker quotes. The Manager's pricing group, which functions independently from its portfolio management personnel, reviews the third-party broker quotes by comparing the broker quotes for reasonableness to alternate sources when available. If independent pricing services or third-party broker quotes are not available, the Company determines the fair value of the securities using valuation techniques that use, when possible, current market-based or independently sourced market parameters, such as interest rates and when applicable, estimates of prepayments and credit losses.

In instances when the Company is required to consolidate a VIE that is determined to be a qualifying collateralized financing entity ("CFE"), under GAAP and if the Company has elected the fair value option for the securitized debt, the Company will measure both the financial assets and financial liabilities of the VIE using the fair value of either the VIE's financial assets or financial liabilities, whichever is more observable.

Mortgage-backed Securities and Other Securities

In determining the proper fair value hierarchy or level the Company considers the amount of available observable market data for each security. For Agency IOs, Non-Agency RMBS, CMBS and other securities, to determine whether a security should be a Level II, the securities are grouped by security type and the Manager reviews the internal trade history, for the quarter, for each security type. If there is sufficient trade data above a predetermined threshold of a security type, the Manager determines it has sufficient observable market data and the security will be categorized as a Level II; otherwise, the security is classified as a Level III.

Values for the Company's securities are based upon prices obtained from independent third-party pricing services. The valuation methodology of the third-party pricing services incorporates market information and commonly used market pricing methods, which include actual trades and quoted prices for similar or identical instruments, and are designed to produce a pricing process that is responsive to market conditions. Depending on the type of asset and the underlying collateral, the primary inputs to the model include yields for TBAs, Agency RMBS, the U.S. Treasury market and floating rate indices such as LIBOR, the Constant Maturity Treasury rate and the prime rate as a benchmark yield. In addition, the model may incorporate the current weighted average maturity and additional pool level information such as prepayment speeds, default frequencies and default severities, if applicable. When the third-party pricing service cannot adequately price a particular security, the Company utilizes a broker's quote which is reviewed for reasonableness by the Manager's pricing group.

Residential Whole Loans and Residential Bridge Loans

Values for the Company's Residential Whole Loans and Residential Bridge Loans are based upon prices obtained from an independent third-party pricing service that specializes in loan valuation, utilizing a discounted cash flow valuation model that is calibrated to recent loan trade execution. Their valuation methodology incorporates commonly used market pricing methods, which include the inputs considered most significant to the determination of fair value of the Company's residential whole loans and residential bridge loans. The key loan inputs include loan balance, interest rate, loan to value, delinquencies and fair value of the collateral for collateral dependent loans. The assumption made by the independent third-party pricing service includes the market discount rate, default assumptions and loss severity. Other inputs and assumptions relevant to the pricing of residential whole loans include FICO scores and prepayment speeds.

The independent third-party pricing service used a combination of recent loan trades and recent residential whole loans securitization transactions adjusted for deal cost and liquidity premium, to form their opinion on the appropriate discount rate.

The Company reviews the analysis provided by pricing service as well as the key assumptions made available to the Company. Due to the inherent uncertainty of such valuation, the fair values established for residential whole loans held by the Company may differ from the fair values that would have been established if a readily available market existed for these loans. In addition, the fair values for the Company's Non-QM residential whole loans held in Arroyo Trust 2022-1 and Arroyo Trust 2022-2, are measured using the fair value of the securitized debt based on the CFE valuation methodology. See Note 5, "Residential Whole Loans and Residential Bridge Loans" to the consolidated financial statements contained in this Annual Report on Form 10-K for additional details. Accordingly, the Company classifies its Residential Whole Loans and Residential Bridge Loans as Level III.

Commercial Loans

Values for the Company's Commercial Loans are based upon prices obtained from an independent third-party pricing service that specializes in loan valuation, utilizing a valuation model that is calibrated to recent loan trade execution. Their valuation methodology incorporates commonly used market pricing methods, which include the inputs considered most significant to the determination of fair value of the Company's commercial loans. The assumptions made by the independent third-party pricing vendor include a market discount rate, default assumption, loss severity, cash flows and probability weighted loss scenarios. The Company reviews the analysis provided by the pricing service as well as the key assumptions. Due to the inherent uncertainty of such valuation, the fair values established for commercial loans held by the Company may differ from the fair values that would have been established if a readily available market existed for these loans. Accordingly, the Company's commercial loans are classified as a Level III.

Securitized Commercial Loans

Values for the Company's securitized commercial loans are based on the collateralized financing entity ("CFE") valuation methodology. Since there is an extremely limited market for the securitized commercial loans, the Company determined the securitized debt is more actively traded and therefore was more observable. Due to the inherent uncertainty of the securitized commercial loans' valuation, the Company classifies its securitized commercial loans as Level III.

Securitized Debt

Values for the Company's securitized debt that the Company elected the fair value option are based upon prices obtained from independent third-party pricing services. The valuation methodology of the third-party pricing services incorporates market information and commonly used market pricing methods, which include actual trades and quoted prices for similar or identical instruments. In determining the proper fair value hierarchy or level, the Company considers the amount of available observable market data for each security. Since the securitized debt represents traded debt securities, the Manager's pricing team reviews the trade activity during the quarter for each security to determine the appropriate level within the fair value hierarchy. If there is sufficient trade data above a predetermined volume threshold, the Manager determines it has sufficient observable market data and the debt security will be categorized as a Level II. If there is not sufficient observable market data the debt security will be categorized as a Level III.

Third party pricing data review

The Company performs quarterly reviews of the independent third-party pricing data. These reviews may include a review of the valuation methodology used by third-party valuation specialists and review of the daily change in the prices provided by the independent pricing vendor which exceed established tolerances or comparisons to executed transaction prices, utilizing the Manager's pricing group. The Manager's pricing group, which functions independently from its portfolio management personnel, reviews the price differences or changes in price by comparing the vendor price to alternate sources including other independent pricing services or broker quotations. If the price change or difference cannot be corroborated, the Manager's pricing group consults with the portfolio management team for market color in reviewing such pricing data as warranted. To the extent that the Manager has information, typically in the form of broker quotations that would indicate that a price received from the independent pricing service is outside of a tolerance range, the Manager generally challenges the independent pricing service price.

The following tables present a summary of the available quantitative information about the significant unobservable inputs used in the fair value measurement of financial instruments for which the Company has utilized Level III inputs to determine fair value as of December 31, 2022 and December 31, 2021 (dollars in thousands):

	Fair Value at December 31, 2022	Valuation Technique	Unobservable Input	Range		Weighted Average
				Minimum	Maximum	
Residential Whole Loans.....	\$ 1,091,145	Discounted Cash Flow	Market Discount Rate	6.0%	8.4%	6.8%
			Weighted Average Life	1.4	10.4	5.4
Residential Bridge Loans.....	\$ 2,849	Discounted Cash Flow	Market Discount Rate	12.9%	35.7%	22.4%
			Weighted Average Life	0.4	4.1	2.0
Securitized Commercial Loans.....	\$ 1,085,103	Market Comparables, Vendor Pricing	Weighted Average Life	2.7	2.7	2.7
Commercial Loans.....	\$ 90,002		Discounted Cash Flow	Market Discount Rate	8.4%	9.6%
			Weighted Average Life	0.3	2.4	1.2

	Fair Value at December 31, 2021	Valuation Technique	Unobservable Input	Range		Weighted Average
				Minimum	Maximum	
Residential Whole-Loans	\$ 1,023,502	Discounted Cash Flow	Market Discount Rate	2.6%	7.5%	3.5%
			Weighted Average Life	1.4	8.9	3.1
Residential Bridge Loans.....	\$ 5,428	Discounted Cash Flow	Market Discount Rate	9.8%	23.1%	17.2%
			Weighted Average Life	0.3	3.6	2.4
Securitized Commercial Loans.....	\$ 1,355,808	Market Comparables, Vendor Pricing	Weighted Average Life	3.6	3.6	3.6
Commercial Loans.....	\$ 130,572		Discounted Cash Flow	Market Discount Rate	4.5%	21.7%
			Weighted Average Life	0.5	2.8	1.2

The following tables present additional information about the Company's financial instruments which are measured at fair value on a recurring basis for which the Company has utilized Level III inputs to determine fair value (dollars in thousands):

	Year ended December 31, 2022						
	Agency MBS	Non- Agency MBS	Residential Whole Loans	Residential Bridge Loans	Commercial Loans	Securitized Commercial Loans	Securitized Debt
Beginning balance	\$ 1,172	\$ 7,845	\$ 1,023,502	\$ 5,428	\$ 130,572	\$ 1,355,808	\$ 14,919
Transfers into Level III from Level II.....	—	—	—	—	—	—	—
Transfers from Level III into Level II.....	—	(5,437)	—	—	—	—	—
Purchases	—	—	399,948	—	—	—	—
Sales and settlements.....	—	—	(11,362)	—	—	—	—
Transfers to REO	—	—	(2,255)	—	—	—	—
Loan modifications/capitalized interest.....	—	—	21	—	—	—	—
Principal repayments	—	—	(204,720)	(2,670)	(20,593)	—	—
Total net gains/losses included in net income							
Realized gains/(losses), net on assets.....	—	—	(101)	—	—	—	—
Unrealized gains/(losses), net on assets ⁽¹⁾	(303)	(863)	(108,698)	91	(19,977)	(297,343)	—
Unrealized (gains)/losses, net on liabilities ⁽²⁾	—	—	—	—	—	—	(1,840)
Premium and discount amortization, net.....	(102)	(341)	(5,190)	—	—	26,638	(4,152)
Ending balance.....	\$ 767	\$ 1,204	\$ 1,091,145	\$ 2,849	\$ 90,002	\$ 1,085,103	\$ 8,927
Unrealized gains/(losses), net on assets held at the end of the period ⁽¹⁾	\$ (303)	\$ (509)	\$ (92,662)	\$ (76)	\$ (19,984)	\$ (297,343)	\$ —
Unrealized gains/(losses), net on liabilities held at the end of the period ⁽²⁾	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 1,840

	Year ended December 31, 2021							
	Agency MBS	Non- Agency MBS	Other Securities	Residential Whole Loans	Residential Bridge Loans	Commercial Loans	Securitized Commercial Loans	Securitized Debt
Beginning balance	\$ 1,708	\$ 34,369	\$ 8,593	\$ 1,008,782	\$ 12,813	\$ 310,523	\$ 1,605,335	\$ 15,418
Transfers into Level III								
from Level II	—	5,683	—	—	—	—	—	—
Transfers from Level III								
into Level II	—	(32,471)	(10,306)	—	—	—	—	—
Purchases	—	—	—	422,041	—	—	—	—
Transfers to REO	—	—	—	—	(752)	(30,000)	—	—
Loan modifications/capitalized								
interest	—	—	—	486	—	—	—	—
Principal repayments	—	(256)	—	(401,075)	(7,312)	(103,285)	(354,202)	—
Total net gains/(losses) included								
in net income								
Realized gains/(losses),								
net on assets	—	—	—	—	(206)	—	—	—
Unrealized gains/(losses),								
net on assets ⁽¹⁾	(206)	698	1,657	2,354	907	(46,813)	79,972	—
Unrealized (gains)/losses,								
net on liabilities ⁽²⁾	—	—	—	—	—	—	—	4,056
Premium and discount amortization,								
net	(330)	(178)	56	(9,086)	(22)	147	24,703	(4,555)
Ending balance	\$ 1,172	\$ 7,845	\$ —	\$ 1,023,502	\$ 5,428	\$ 130,572	\$ 1,355,808	\$ 14,919
Unrealized gains/(losses), net on								
assets held at the end of the								
period ⁽¹⁾	\$ (206)	\$ (1,173)	\$ —	\$ 5,795	\$ 149	\$ (50,034)	\$ 64,973	\$ —
Unrealized gains/(losses), net on								
liabilities held at the end of the								
period ⁽²⁾	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ (3,603)

(1) Gains and losses are included in “Unrealized loss, net” in the Consolidated Statements of Operations.

(2) Gains and losses on securitized debt are included in “Unrealized loss, net” in the Consolidated Statements of Operations.

Transfers between hierarchy levels for the years ended December 31, 2022 and December 31, 2021 were based on the availability of sufficient observable inputs. Movements from Level II to Level III was based on the back-testing of historical sales transactions performed by the Manager, which did not provide sufficient observable data to meet Level II versus Level III criteria, resulting in the movement from Level II to Level III. Movements from Level III to Level II was based on information received from a third party pricing service which, along with the back-testing of historical sales transactions performed by the Manager, provided the sufficient observable data for the movement from Level III to Level II. The Company did not have transfers between either Level I and Level II or Level I and Level III for the years ended December 31, 2022 and December 31, 2021.

Other Fair Value Disclosures

The Company’s repurchase agreements, convertible senior unsecured notes, and securitized debt from the Arroyo 2019-2 and Arroyo 2020-1 trusts are not carried at fair value in the consolidated financial statements.

Borrowings under repurchase agreements

The fair values of the Company’s repurchase agreements approximates the carrying value due to the floating interest rates that are based on an index plus a spread, which is typically consistent with those demanded in the market and the short-term maturities of generally one year or less. The Company’s repurchase agreements are classified as Level II.

Convertible senior unsecured notes

The fair value of the convertible senior unsecured notes is based on quoted market prices. Accordingly, the Company’s convertible senior unsecured notes are classified as Level I.

The following table presents the carrying value and estimated fair value of the Company's convertible senior unsecured notes and securitized debt that are not carried at fair value as of December 31, 2022 and December 31, 2021 in the consolidated financial statements (dollars in thousands):

	December 31, 2022		December 31, 2021	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Convertible senior unsecured notes.....	83,522	74,712	119,168	122,133
Securitized debt ⁽¹⁾	342,965	309,474	524,649	528,046
Total	<u>\$ 426,487</u>	<u>\$ 384,186</u>	<u>\$ 643,817</u>	<u>\$ 650,179</u>

(1) Carrying value excludes \$4.1 million and \$5.5 million of deferred financing costs as of December 31, 2022 and December 31, 2021, respectively.

“Due from counterparties” and “Due to counterparties” in the Company's Consolidated Balance Sheets are reflected at cost which approximates fair value.

Note 4 - Mortgage-Backed Securities and other securities

The following tables present certain information about the Company's investment portfolio at December 31, 2022 and December 31, 2021 (dollars in thousands):

	December 31, 2022						
	Principal Balance	Unamortized Premium (Discount), net	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value	Net Weighted Average Coupon ⁽⁴⁾
Agency RMBS Interest-Only Strips ⁽¹⁾	N/A	N/A	\$ 58	\$ —	\$ (5)	\$ 53	—%
Agency RMBS Interest-Only Strips, accounted for as derivatives ⁽¹⁾⁽²⁾	N/A	N/A	N/A	N/A	N/A	714	0.1%
Total Agency MBS	—	—	58	—	(5)	767	0.1%
Non-Agency RMBS.....	39,873	(14,423)	25,450	928	(3,895)	22,483	4.2%
Non-Agency RMBS Interest- Only Strips ⁽¹⁾	N/A	N/A	5,204	—	(4,000)	1,204	0.3%
Subtotal Non-Agency RMBS	39,873	(14,423)	30,654	928	(7,895)	23,687	1.1%
Non-Agency CMBS.....	109,266	(2,763)	106,503	636	(21,704)	85,435	8.1%
Total Non-Agency MBS.....	149,139	(17,186)	137,157	1,564	(29,599)	109,122	3.8%
Other securities ⁽³⁾	34,691	(8,581)	31,112	543	(4,393)	27,262	7.2%
Total	<u>\$ 183,830</u>	<u>\$ (25,767)</u>	<u>\$ 168,327</u>	<u>\$ 2,107</u>	<u>\$ (33,997)</u>	<u>\$ 137,151</u>	<u>3.9%</u>

	December 31, 2021						
	Principal Balance	Unamortized Premium (Discount), net	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value	Net Weighted Average Coupon ⁽⁴⁾
Agency RMBS Interest-Only Strips ⁽¹⁾	N/A	N/A	\$ 59	\$ 55	\$ —	\$ 114	1.3%
Agency RMBS Interest-Only Strips, accounted for as derivatives ⁽¹⁾⁽²⁾	N/A	N/A	N/A	N/A	N/A	1,058	1.3%
Total Agency MBS	—	—	59	55	—	1,172	1.3%
Non-Agency RMBS.....	36,147	(13,936)	22,211	3,476	(35)	25,652	4.3%
Non-Agency RMBS Interest- Only Strips ⁽¹⁾	N/A	N/A	5,608	—	(3,491)	2,117	0.3%
Subtotal Non-Agency RMBS	36,147	(13,936)	27,819	3,476	(3,526)	27,769	1.0%
Non-Agency CMBS.....	179,619	(13,088)	166,531	1,543	(62,716)	105,358	5.4%
Total Non-Agency MBS.....	215,766	(27,024)	194,350	5,019	(66,242)	133,127	3.0%
Other securities ⁽³⁾	51,159	(8,229)	47,652	4,209	(213)	51,648	5.6%
Total	<u>\$ 266,925</u>	<u>\$ (35,253)</u>	<u>\$ 242,061</u>	<u>\$ 9,283</u>	<u>\$ (66,455)</u>	<u>\$ 185,947</u>	<u>3.2%</u>

(1) IOs and IIOs have no principal balances and bear interest based on a notional balance. The notional balance is used solely to determine interest distributions on interest-only class of securities. At December 31, 2022, the notional balance for Agency RMBS IOs and IIOs, Non-Agency RMBS IOs and IIOs, and Agency RMBS IOs and IIOs, accounted for as derivatives was \$2.4 million, \$143.2 million and \$13.1 million, respectively. At December 31, 2021, the notional balance for Agency RMBS IOs and IIOs, Non-Agency RMBS IOs and IIOs and Agency RMBS IOs and IIOs accounted for as derivatives was \$2.9 million, \$181.0 million and \$16.8 million, respectively.

(2) Interest on these securities is reported as a component of “Gain (loss) on derivative instruments, net” in the Consolidated Statements of Operations.

(3) Other securities include residual interests in asset-backed securities which have no principal balance and an amortized cost of approximately \$5.0 million and \$4.7 million, as of December 31, 2022 and December 31, 2021, respectively.

(4) The calculation of the weighted average coupon rate includes the weighted average coupon rates of IOs and IIOs accounted for as derivatives using their notional amounts.

As of December 31, 2022 and December 31, 2021, the weighted average expected remaining term of the MBS and other securities investment portfolio was 6.7 years and 5.9 years, respectively.

The following tables present the fair value and contractual maturities of the Company's investment securities at December 31, 2022 and December 31, 2021 (dollars in thousands):

	December 31, 2022				
	< or equal to 10 years	> 10 years and < or equal to 20 years	> 20 years and < or equal to 30 years	> 30 years	Total
Agency RMBS Interest-Only Strips.....	\$ —	\$ 53	\$ —	\$ —	\$ 53
Agency RMBS Interest-Only Strips, accounted for as derivatives.....	—	714	—	—	714
Subtotal Agency.....	—	767	—	—	767
Non-Agency CMBS.....	64,484	10,469	10,482	—	85,435
Non-Agency RMBS.....	—	—	8,667	13,816	22,483
Non-Agency RMBS Interest-Only Strips.....	—	—	230	974	1,204
Subtotal Non-Agency.....	64,484	10,469	19,379	14,790	109,122
Other securities.....	6,735	—	13,020	7,507	27,262
Total.....	\$ 71,219	\$ 11,236	\$ 32,399	\$ 22,297	\$ 137,151

	December 31, 2021				
	< or equal to 10 years	> 10 years and < or equal to 20 years	> 20 years and < or equal to 30 years	> 30 years	Total
Agency RMBS Interest-Only Strips.....	\$ —	\$ —	\$ 114	\$ —	\$ 114
Agency RMBS Interest-Only Strips, accounted for as derivatives.....	—	1,058	—	—	1,058
Subtotal Agency.....	—	1,058	114	—	1,172
Non-Agency CMBS.....	66,384	17,644	21,171	159	105,358
Non-Agency RMBS.....	—	—	10,282	15,370	25,652
Non-Agency RMBS Interest-Only Strips.....	—	—	106	2,011	2,117
Subtotal Non-Agency.....	66,384	17,644	31,559	17,540	133,127
Other securities.....	9,255	4,266	25,653	12,474	51,648
Total.....	\$ 75,639	\$ 22,968	\$ 57,326	\$ 30,014	\$ 185,947

The following tables present the gross unrealized losses and estimated fair value of the Company's MBS and other securities by length of time that such securities have been in a continuous unrealized loss position at December 31, 2022 and December 31, 2021 (dollars in thousands):

	December 31, 2022								
	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities
Agency RMBS Interest-Only Strips.....	\$ 52	\$ (5)	1	\$ —	\$ —	—	\$ 52	\$ (5)	1
Subtotal Agency.....	52	(5)	1	—	—	—	52	(5)	1
Non-Agency CMBS.....	—	—	—	76,365	(21,704)	11	76,365	(21,704)	11
Non-Agency RMBS.....	19,054	(2,794)	5	1,557	(1,101)	2	20,611	(3,895)	7
Non-Agency RMBS Interest-Only Strips.....	—	—	—	1,203	(4,000)	4	1,203	(4,000)	4
Subtotal Non-Agency.....	19,054	(2,794)	5	79,125	(26,805)	17	98,179	(29,599)	22
Other securities.....	12,483	(2,425)	3	9,468	(1,968)	2	21,951	(4,393)	5
Total.....	\$ 31,589	\$ (5,224)	9	\$ 88,593	\$ (28,773)	19	\$ 120,182	\$ (33,997)	28

	December 31, 2021								
	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities
Non-Agency CMBS.....	\$ —	\$ —	—	\$ 96,080	\$ (62,716)	16	\$ 96,080	\$ (62,716)	16
Non-Agency RMBS.....	—	—	—	201	(35)	1	201	(35)	1
Non-Agency RMBS Interest-Only Strips	—	—	—	2,117	(3,491)	4	2,117	(3,491)	4
Subtotal Non-Agency	—	—	—	98,398	(66,242)	21	98,398	(66,242)	21
Other securities	—	—	—	9,022	(213)	4	9,022	(213)	4
Total	\$ —	\$ —	—	\$ 107,420	\$ (66,455)	25	\$ 107,420	\$ (66,455)	25

The following table presents components of interest income on the Company's MBS and other securities for the three years ended December 31, 2022, December 31, 2021 and December 31, 2020, respectively (dollars in thousands):

	For the year ended December 31, 2022			For the year ended December 31, 2021			For the year ended December 31, 2020		
	Net (Premium Amortization/Amortization Basis)			Net (Premium Amortization/Amortization Basis)			Net (Premium Amortization/Amortization Basis)		
	Coupon Interest	Discount Amortization	Interest Income	Coupon Interest	Discount Amortization	Interest Income	Coupon Interest	Discount Amortization	Interest Income
Agency CMBS.....	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 11,336	\$ (636)	\$ 10,700
Agency RMBS.....	13	(1)	12	47	(30)	17	2,975	(987)	1,988
Non-Agency CMBS.....	9,129	615	9,744	9,874	6,535	16,409	15,331	6,467	21,798
Non-Agency RMBS.....	2,154	(46)	2,108	2,127	(670)	1,457	2,732	(1,193)	1,539
Other securities	3,383	274	3,657	4,685	(1,574)	3,111	8,263	(4,781)	3,482
Total	\$ 14,679	\$ 842	\$ 15,521	\$ 16,733	\$ 4,261	\$ 20,994	\$ 40,637	\$ (1,130)	\$ 39,507

The following tables present the sales and realized gain (loss) of the Company's MBS and other securities for the three years ended December 31, 2022, December 31, 2021 and December 31, 2020, respectively (dollars in thousands):

	For the year ended December 31, 2022			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Non-Agency CMBS	\$ 10,152	\$ —	\$ (43,934)	\$ (43,934)
Non-Agency RMBS	31,790	255	(2,652)	(2,397)
Other securities	14,485	—	(2,252)	(2,252)
Total	\$ 56,427	\$ 255	\$ (48,838)	\$ (48,583)

	For the year ended December 31, 2021			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Non-Agency CMBS	\$ 27,488	\$ —	\$ (9,266)	\$ (9,266)
Total	\$ 27,488	\$ —	\$ (9,266)	\$ (9,266)

	For the year ended December 31, 2020			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency CMBS	\$ 1,668,149	\$ 116,463	\$ (6,486)	\$ 109,977
Agency RMBS	400,948	12,552	(506)	12,046
Non-Agency CMBS	111,804	1	(23,624)	(23,623)
Non-Agency RMBS	12,658	—	(60)	(60)
Other securities	35,957	113	(6,223)	(6,110)
Total	\$ 2,229,516	\$ 129,129	\$ (36,899)	\$ 92,230

Unconsolidated CMBS VIEs

The Company's economic interests held in unconsolidated CMBS VIEs are limited in nature to those of a passive holder of CMBS issued by securitization trusts. The Company was not involved in the design or creation of the securitization trusts. The Company evaluates its CMBS holdings for potential consolidation of the securitized trust, in which it owns the most subordinate tranche or a portion of the controlling class. As of December 31, 2022 and December 31, 2021, the Company held two and five variable interests in unconsolidated CMBS VIEs, respectively, in which it either owned the most subordinate class or a portion of the controlling class. The Company determined it was not the primary beneficiary and accordingly, the CMBS VIEs were not consolidated in the Company's consolidated financial statements. As of December 31, 2022 and December 31, 2021, the Company's maximum exposure to loss from these variable interests did not exceed the carrying value of these investments of \$15.5 million and \$26.5 million, respectively. These investments are classified in "Non-Agency mortgage-backed securities, at

fair value” in the Company’s Consolidated Balance Sheets. Further, as of December 31, 2022 and December 31, 2021, the Company did not guarantee any obligations of unconsolidated entities or enter into any commitment or intent to provide funding to any such entities.

Note 5—Residential Whole Loans and Residential Bridge Loans

Residential whole loan trusts

Revolving Mortgage Investment Trust 2015-1QR2

Revolving Mortgage Investment Trust 2015-1QR2 (“RMI 2015 Trust”) was formed to acquire Non-QM Residential Whole Loans. RMI 2015 Trust issued a trust certificate that is wholly-owned by the Company and represents the entire beneficial interest in pools of Non-QM Residential Whole Loans held by the trust. The Company consolidates the trust since it met the definition of a VIE and the Company determined that it was the primary beneficiary. The Company classifies the underlying Non-QM Residential Whole Loans owned by the trust in “Residential Whole Loans, at fair value” in the Consolidated Balance Sheets and has eliminated the intercompany trust certificate in consolidation.

As of December 31, 2022, and December 31, 2021, the RMI 2015 Trust owns six and 770 Non-QM Residential Whole Loans with a fair value of \$3.2 million and \$451.7 million, respectively. The loans are financed under the Company’s residential whole loan facility, and the Company holds the financing liability outside the RMI 2015 Trust. Refer to Note 7, “Financings” to the consolidated financial statements contained in this Annual Report on Form 10-K.

Arroyo Mortgage Trust 2019-2

In May 2019, the Company formed Arroyo Mortgage Trust 2019-2 (“Arroyo Trust 2019”), a wholly-owned subsidiary of the Company, to complete its first residential mortgage-backed securitization comprised \$945.5 million of Non-QM Residential Whole Loans. The Arroyo Trust 2019 issued \$919.0 million of mortgage-backed notes and retained all the subordinate and residual debt securities (“Owner Certificates”), which includes the required 5% eligible risk retention. Refer to Note 7, “Financings” to the consolidated financial statements contained in this Annual Report on Form 10-K for additional details. The Company consolidates the trust since it met the definition of a VIE and the Company determined that it was the primary beneficiary. The Company classifies the underlying Non-QM Residential Whole Loans in “Residential Whole Loans, at fair value” in the Consolidated Balance Sheets and eliminated intercompany Owner Certificates in consolidation.

As of December 31, 2022, and December 31, 2021, the Arroyo Trust 2019 owns 766 and 1,042 Non-QM Residential Whole Loans with a fair value of \$237.6 million and \$374.3 million, respectively.

Arroyo Mortgage Trust 2020-1

In June 2020, the Company formed Arroyo Mortgage Trust 2020-1 (“Arroyo Trust 2020”), a wholly-owned subsidiary of the Company, to complete its second residential mortgage-backed securitization comprised of \$355.8 million of Non-QM Residential Whole Loans. The Arroyo Trust 2020 issued \$341.7 million of mortgage-backed notes and retained all the subordinate and residual debt securities, which includes the required 5% eligible risk retention. Refer to Note 7, “Financings” to the consolidated financial statements contained in this Annual Report on Form 10-K. The Company consolidates the trust since it met the definition of a VIE and the Company determined that it was the primary beneficiary. The Company classifies the underlying Non-QM Residential Whole Loans in “Residential Whole Loans, at fair value” in the Consolidated Balance Sheets and eliminated intercompany Owner Certificates in consolidation.

As of December 31, 2022, and December 31, 2021, the Arroyo Trust 2020 owned 432 and 543 Non-QM Residential Whole Loans with a fair value of \$135.1 million and \$195.7 million, respectively.

Arroyo Mortgage Trust 2022-1

In February 2022, the Company formed Arroyo Mortgage Trust 2022-1 (“Arroyo Trust 2022-1”), a wholly-owned subsidiary of the Company, to complete its third residential mortgage-backed securitization comprised of \$432.0 million of Non-QM Residential Whole Loans. The Arroyo Trust 2022-1 issued \$398.9 million of mortgage-backed notes and retained all the subordinate and residual debt securities, which includes the required 5% eligible risk retention. Refer to Note 7, “Financings” to the consolidated financial statements contained in this Annual Report on Form 10-K. The Company consolidates the trust since it met the definition of a VIE and the Company determined that it was the primary beneficiary. The Company classifies the underlying Non-QM Residential Whole Loans in “Residential Whole Loans, at fair value” in the Consolidated Balance Sheets and eliminated the intercompany Owners Certificates.

As of December 31, 2022, the Arroyo Trust 2022-1 owned 705 Non-QM Residential Whole Loans with a fair value of \$350.7 million. The Company has elected the fair value option for the securitized debt. The fair values for the Company’s Non-QM loans held in the Arroyo Trust 2022-1 are measured using the fair value of the securitized debt based on the CFE valuation methodology. The Company determined that the securitized debt is more actively traded and, therefore, more observable.

Arroyo Mortgage Trust 2022-2

In July 2022, the Company formed Arroyo Mortgage Trust 2022-2 (“Arroyo Trust 2022-2”), a wholly-owned subsidiary of the Company, to complete its fourth residential mortgage-backed securitization comprised of \$402.2 million of Non-QM Residential Whole Loans. The Arroyo Trust 2022-2 issued \$351.9 million of mortgage-backed notes and retained all the subordinate and residual debt securities, which includes the required 5% eligible risk retention. Note 7, “Financings” to the consolidated financial statements contained in this Annual Report on Form 10-K. The Company consolidates the trust since it met

the definition of a VIE and the Company determined that it was the primary beneficiary. The Company classifies the underlying Non-QM Residential Whole Loans in “Residential Whole Loans, at fair value” in the Consolidated Balance Sheets and eliminated the intercompany Owners Certificates.

As of December 31, 2022, the Arroyo Trust 2022-2 owned 1,029 Non-QM Residential Whole Loans with a fair value of \$363.3 million. The Company has elected the fair value option for the securitized debt. The fair values for the Company’s Non-QM loans held in the Arroyo Trust 2022-2 are measured using the fair value of the securitized debt based on the CFE valuation methodology. The Company determined that the securitized debt is more actively traded and, therefore, more observable.

Residential bridge loan trust

In February 2017, the Company formed Revolving Mortgage Investment Trust 2017-BRQ1 (“RMI 2017 Trust”) to acquire Residential Bridge Loans. RMI 2017 Trust issued a trust certificate that is wholly-owned by the Company and represents the entire beneficial interest in pools of Residential Bridge Loans and certain Residential Whole Loans held by the trust. Residential Bridge Loans are mortgage loans secured by residences, typically short-term. The Company consolidates the trust since it met the definition of a VIE and the Company determined that it was the primary beneficiary. The Company has eliminated the intercompany trust certificate in consolidation.

The Company is no longer allocating capital to Residential Bridge Loans. As of December 31, 2022, and December 31, 2021 there were five and eight remaining Residential Bridge Loans in the portfolio with a fair value of \$2.8 million and \$5.2 million, respectively. As of December 31, 2022, and December 31, 2021, the trust also owned five and six investor fixed rate residential mortgages with a fair value of \$1.2 million and \$1.7 million, respectively.

Consolidated residential whole loan and residential bridge loan trusts

The following table presents a summary of the assets and liabilities of the consolidated residential whole loan trusts and residential bridge loan trust included in the Consolidated Balance Sheets as of December 31, 2022 and December 31, 2021 (dollars in thousands):

	December 31, 2022	December 31, 2021
Cash and cash equivalents.....	\$ —	\$ 266
Residential Whole Loans, at fair value (\$1,089,914 and \$1,023,502 pledged as collateral, at fair value, respectively).....	1,091,145	1,023,502
Residential Bridge Loans, at fair value (\$— and \$5,207 pledged as collateral, at fair value, respectively).....	2,849	5,207
Investment related receivable.....	5,914	22,087
Interest receivable.....	4,871	5,282
Other assets.....	509	—
Total assets.....	<u>\$ 1,105,288</u>	<u>\$ 1,056,344</u>
Securitized debt, net.....	\$ 981,073	\$ 519,118
Interest payable.....	3,139	1,316
Accounts payable and accrued expenses.....	34	69
Total liabilities.....	<u>\$ 984,246</u>	<u>\$ 520,503</u>

The Residential Whole Loans held by the consolidated Arroyo Trust 2019, Arroyo Trust 2020, Arroyo Trust 2022-1 and Arroyo Trust 2022-2 are held solely to satisfy the liabilities of each respective trust, and has no recourse to the general credit of the Company. The Company is not contractually required and has not provided any additional financial support to the these trusts for the years ended December 31, 2022 and December 31, 2021.

The following table presents the components of the carrying value of Residential Whole Loans and Residential Bridge Loans as of December 31, 2022 and December 31, 2021 (dollars in thousands):

	Residential Whole Loans, at Fair Value		Residential Bridge Loans, at Fair Value	
	December 31, 2022	December 31, 2021	December 31, 2022	December 31, 2021
Principal balance.....	\$ 1,165,301	\$ 989,143	\$ 3,166	\$ 5,834
Unamortized premium.....	30,961	31,070	—	—
Unamortized discount.....	(1,536)	(1,337)	—	—
Amortized cost.....	1,194,726	1,018,876	3,166	5,834
Gross unrealized gains.....	2,038	14,190	—	78
Gross unrealized losses.....	(105,619)	(9,564)	(317)	(484)
Fair value.....	<u>\$ 1,091,145</u>	<u>\$ 1,023,502</u>	<u>\$ 2,849</u>	<u>\$ 5,428</u>

Residential whole loans

The Residential Whole Loans have low LTV's and are comprised of 2,938 Non-QM adjustable rate mortgages and five investor fixed rate residential mortgages. The following tables present certain information about the Company's residential whole loan investment portfolio at December 31, 2022 and December 31, 2021 (dollars in thousands):

December 31, 2022							
Current Coupon Rate	Number of Loans	Principal Balance	Weighted Average				
			Original LTV	Original FICO Score ⁽¹⁾	Expected Life (years)	Contractual Maturity (years)	Coupon Rate
2.01% - 3.00%	39	\$ 22,277	66.3%	758	8.9	28.3	2.9%
3.01% - 4.00%	402	214,402	66.3%	759	7.3	28.5	3.7%
4.01% - 5.00%	1,337	453,811	64.1%	749	5.5	26.0	4.6%
5.01% - 6.00%	901	363,197	65.6%	742	4.7	26.7	5.4%
6.01% - 7.00%	249	105,933	69.9%	742	3.6	28.4	6.4%
7.01% - 8.00%	15	5,681	75.2%	730	3.0	29.2	7.4%
Total	2,943	\$ 1,165,301	65.6%	748	5.5	27.0	4.8%

(1) The original FICO score is not available for 231 loans with a principal balance of approximately \$76.6 million at December 31, 2022. The Company has excluded these loans from the weighted average computations.

December 31, 2021							
Current Coupon Rate	Number of Loans	Principal Balance	Weighted Average				
			Original LTV	Original FICO Score ⁽¹⁾	Expected Life (years)	Contractual Maturity (years)	Coupon Rate
2.01% - 3.00%	27	\$ 15,640	65.1%	757	5.3	28.8	2.8%
3.01% - 4.00%	496	244,022	63.7%	756	3.3	28.0	3.7%
4.01% - 5.00%	1,051	413,451	65.1%	747	2.9	28.2	4.7%
5.01% - 6.00%	757	305,344	64.9%	738	3.0	26.8	5.4%
6.01% - 7.00%	28	10,181	67.9%	721	3.1	25.8	6.3%
7.01% - 8.00%	2	505	73.2%	753	4.5	26.8	7.1%
Total	2,361	\$ 989,143	64.8%	746	3.1	27.7	4.6%

(1) The original FICO score is not available for 230 loans with a principal balance of approximately \$74.3 million at December 31, 2021. The Company has excluded these loans from the weighted average computations.

The following table presents the various states across the United States in which the collateral securing the Company's Residential Whole Loans at December 31, 2022 and December 31, 2021, based on principal balance, is located (dollars in thousands):

December 31, 2022			December 31, 2021		
State	State Concentration	Principal Balance	State	State Concentration	Principal Balance
California	66.8%	\$ 778,732	California	73.9%	\$ 730,771
New York	9.3%	108,108	New York	11.6%	114,625
Texas	4.8%	56,126	Florida	2.7%	26,293
Florida	4.1%	47,681	Georgia	2.5%	25,106
Georgia	3.5%	40,845	Texas	1.9%	19,062
Other	11.5%	133,809	Other	7.4%	73,286
Total	100.0%	\$ 1,165,301	Total	100.0%	\$ 989,143

Residential bridge loans

The Company is no longer allocating capital to Residential Bridge Loans. The following tables present certain information about the remaining Residential Bridge Loans in the Company's investment portfolio at December 31, 2022 and December 31, 2021 (dollars in thousands):

December 31, 2022					
Current Coupon Rate	Number of Loans	Principal Balance	Original LTV	Weighted Average	
				Contractual Maturity (months) ⁽¹⁾	Coupon Rate
7.01% – 9.00%	2	\$ 1,822	67.5%	N/A	8.7%
9.01% – 11.00%	1	849	90.5%	0.0	10.0%
11.01% – 13.00%	2	495	69.7%	0.0	11.4%
Total	5	\$ 3,166	74.0%	0.0	9.5%

December 31, 2021					
Current Coupon Rate	Number of Loans	Principal Balance	Original LTV	Weighted Average	
				Contractual Maturity (months) ⁽¹⁾	Coupon Rate
7.01% – 9.00%	3	\$ 2,946	70.4%	0.0	8.8%
9.01% – 11.00%	4	2,393	76.7%	0.0	10.4%
11.01% – 13.00%	2	495	69.7%	0.0	11.4%
Total	9	\$ 5,834	72.9%	0.0	9.7%

(1) Non-performing loans that are past their maturity date are excluded from the calculation of the weighted average contractual maturity. The weighted average contractual maturity for these loans is zero.

The following table presents the various states across the United States in which the collateral securing the Company's Residential Bridge Loans at December 31, 2022 and December 31, 2021, based on principal balance, is located (dollars in thousands):

December 31, 2022			December 31, 2021		
State	State Concentration	Principal Balance	State	State Concentration	Principal Balance
California	55.4%	\$ 1,754	New York	45.1%	\$ 2,631
New York	42.2%	1,337	California	30.1%	1,754
New Jersey	2.4%	75	Florida	19.3%	1,125
Total	100.0%	\$ 3,166	New Jersey	3.7%	219
			Pennsylvania	1.8%	105
			Other	—%	—
			Total	100.0%	\$ 5,834

Non-performing loans

The following table presents the aging of the Residential Whole Loans and Residential Bridge Loans as of December 31, 2022 (dollars in thousands):

	Residential Whole Loans ⁽¹⁾			Residential Bridge Loans		
	No of Loans	Principal	Fair Value	No of Loans	Principal	Fair Value
Current ⁽¹⁾	2,910	\$ 1,147,412	\$ 1,074,409	—	\$ —	\$ —
1-30 days	14	6,983	6,678	—	—	—
31-60 days	—	—	—	—	—	—
61-90 days	6	2,165	2,032	—	—	—
90+ days	13	8,741	8,026	5	3,166	2,849
Total	2,943	\$ 1,165,301	\$ 1,091,145	5	\$ 3,166	\$ 2,849

(1) As of December 31, 2022, there were no loans in forbearance.

Residential whole loans

As of December 31, 2022, there were 13 Residential Whole Loans carried at fair value in non-accrual status with an unpaid principal balance of approximately \$8.7 million and a fair value of approximately \$8.0 million. These nonperforming loans represent approximately 0.8% of the total outstanding principal balance. These loans are collateral dependent with a weighted average original LTV of 60.0%.

As of December 31, 2021, there were 20 Residential Whole Loans carried at fair value in non-accrual status with an unpaid principal balance of approximately \$12.2 million and a fair value of approximately \$12.0 million. These nonperforming loans represent approximately 1.2% of the total outstanding principal balance. These loans are collateral dependent with a weighted average original LTV of 60.0%.

These loans are carried at fair value, and accordingly no allowance for credit losses or credit loss expense was recorded, since the adjustment for credit losses, if any, would be reflected in the fair value of these loans as a component of “Unrealized loss, net” in the Consolidated Statements of Operations. The Company stopped accruing interest income for these loans when they became contractually 90 days delinquent.

Residential bridge loans

As of December 31, 2022, the Company had five remaining Residential Bridge Loans in the portfolio. Of these, five in non-accrual status with an unpaid principal balance of approximately \$3.2 million and a fair value of \$2.8 million. These nonperforming loans had an outstanding principal balance of \$3.2 million. These loans are collateral dependent.

As of December 31, 2021, the Company had nine Residential Bridge Loans remaining in the portfolio. Of these, six were in non-accrual status with an unpaid principal balance of approximately \$4.8 million and a fair value of \$4.4 million. These nonperforming loans had an outstanding principal balance of \$5.8 million. These loans are collateral dependent.

The remaining Residential Bridge Loans were carried at fair value. No allowance for credit losses was recorded because the valuation adjustment as of December 31, 2022 and December 31, 2021, if any, would be reflected in the fair value of these loans. The Company stopped accruing interest income for these loans when they became contractually 90 days delinquent.

Residential real estate owned

As of December 31, 2022 and December 31, 2021, the Company had one and four residential REO properties with an aggregate carrying value of \$2.3 million and \$1.1 million, respectively, related to foreclosed Residential Whole Loans and Residential Bridge Loans. The REO loan held by the Company as of December 31, 2022 was transferred to REO in December 2022. The residential REO properties are held for sale and accordingly carried at the lower of cost or fair value less cost to sell. The residential REO properties are classified in “Other assets” in the Consolidated Balance Sheets.

Note 6 - Commercial Loans

Commercial Loans

In January 2019, WMC CRE LLC (“CRE LLC”), a wholly-owned subsidiary of the Company, was formed for the purpose of acquiring Commercial Loans. The Commercial Loans owned by CRE LLC are financed under the Commercial Whole Loan Facility. Refer to Note 7, “Financings” to the consolidated financial statements contained in this Annual Report on Form 10-K for details.

The following table presents information about the Commercial Loans owned by CRE LLC as of December 31, 2022 (dollars in thousands):

Loan	Acquisition Date	Loan Type	Principal Balance	Fair Value	Original LTV	Interest Rate	Maturity Date	Extension Option	Collateral
CRE 3	August 2019	Interest-Only Mezzanine loan	\$ 90,000	\$ 8,777	58%	1-Month LIBOR plus 9.25%	6/29/2021	None ⁽¹⁾	Entertainment and Retail
CRE 4	September 2019	Interest-Only First Mortgage	22,204	22,050	63%	1-Month SOFR plus 3.38%	8/6/2025 ⁽²⁾	None	Retail
CRE 5	December 2019	Interest-Only First Mortgage	24,535	24,433	62%	1-Month LIBOR plus 3.75%	11/6/2023 ⁽³⁾	One - 12 month extension	Hotel
CRE 6	December 2019	Interest-Only First Mortgage	13,207	13,151	62%	1-Month LIBOR plus 3.75%	11/6/2023 ⁽³⁾	One - 12 month extension	Hotel
CRE 7	December 2019	Interest-Only First Mortgage	7,259	7,229	62%	1-Month LIBOR plus 3.75%	11/6/2023 ⁽³⁾	One - 12 month extension	Hotel
			<u>\$ 157,205</u>	<u>\$ 75,640</u>					

(1) At December 31, 2022 CRE 3 was in default and was not eligible for extension. On February 3, 2023, it was sold to an unaffiliated third party for its fair value as of December 31, 2022.

(2) CRE 4 was granted a three-year extension through August 6, 2025, in conjunction with a principal paydown of \$16.2 million.

(3) CRE 5, 6, and 7 were each granted a one-year extension through November 6, 2023 and are expected to transition off LIBOR during Q2 2023.

CRE 3 Loan

As of December 31, 2022, the CRE 3 junior mezzanine loan with an outstanding principal balance of \$90.0 million was non-performing and past its maturity date of June 29, 2021. On October 25, 2022, the senior mezzanine lender notified the Company that it had consummated a strict foreclosure under the Uniform Commercial Code of its equity interest in the mortgage borrower, which had the effect of foreclosing out the Company's subordinate pledge of equity in the retail facility that served as collateral for the junior mezzanine loan. As a result, as of December 31, 2022, the Company's junior mezzanine loan remained outstanding but without the benefit of the primary collateral supporting the loan.

As a result of the foreclosure noted above, the Company marked down the value of its investment in the CRE 3 junior mezzanine loan from \$26.9 million at June 30, 2022 to \$8.8 million at September 30, 2022. On February 3, 2023, the CRE 3 loan was sold to an unaffiliated third party for its value of \$8.8 million. The fair value of the loan at December 31, 2022 reflects this purchase price.

Commercial loan payoffs

On September 16, 2022, CRE 8, which had an outstanding principal balance of \$4.4 million collateralized by assisted living facilities, was paid off in full.

Commercial loan trust

In March 2018, the Company formed the Revolving Small Balance Commercial Trust 2018-1 ("RSBC Trust") to acquire commercial real estate mortgage loans. The Company consolidates the trust because it determined that the wholly-owned RSBC Trust was a VIE and that the Company was the primary beneficiary. As of December 31, 2022, there is one loan remaining in the trust.

The following table presents information on the commercial real estate mortgage loan held by RSBC Trust as of December 31, 2022 (dollars in thousands):

Loan	Acquisition Date	Loan Type	Principal Balance	Fair Value	Original LTV	Interest Rate ⁽¹⁾	Maturity Date	Extension Option	Collateral
SBC 3.....	January 2019	Interest-Only First Mortgage	\$ 14,362	\$ 14,362	49%	One-Month LIBOR plus 4.35%	1/6/2023	None	Nursing Facilities
			<u>\$ 14,362</u>	<u>\$ 14,362</u>					

(1) During July 2022, the SBC 3 loan was granted an extension through January 6, 2023, with a 25 bps increase in rate and a 25 bps extension fee. Subsequently, in January 2023, the SBC 3 loan was partially paid down by \$750.0 thousand and was granted another extension through August 4, 2023, with a 50 bps extension fee.

Securitized commercial loans

Securitized commercial loans are comprised of commercial loans from consolidated third party sponsored CMBS VIE's. At December 31, 2022, the Company had a variable interest in one third party sponsored CMBS VIEs, CSMC Trust 2014-USA, that it determined it was the primary beneficiary and was required to consolidate. The commercial loans that serve as collateral for the securitized debt issued by this VIE can only be used to settle the securitized debt. Refer to Note 7, "Financings" to the consolidated financial statements contained in this Annual Report on Form 10-K for details on the associated securitized debt. The Company assesses modifications to VIEs on an ongoing basis to determine if a significant reconsideration event has occurred that would change the Company's initial consolidation assessment.

RETL 2019-RVP

RETL 2018 was refinanced with a new securitization RETL 2019-RVP ("RETL 2019 Trust") in March 2019. The Company acquired a \$65.3 million interest in the trust certificates issued by the RETL 2019 Trust, including \$45.3 million which represents the 5% eligible risk retention certificate. The Company determined that RETL 2019 Trust was a VIE and that the Company was also the primary beneficiary because the Manager was involved in certain aspects of the design of the trust and the Company together with other related party entities own more than 50% of the controlling class. As the primary beneficiary, the Company consolidated RETL 2019 Trust and its investment in the trust certificates (HRR class and a portion of the C class) of RETL 2019 Trust was eliminated in consolidation. The RETL 2019 Trust held a commercial loan collateralized by first mortgages, deeds of trusts and interests in commercial real estate.

On September 15, 2021, the commercial loan was paid in full by the borrower and the RETL HRR bond which had an outstanding principal amount of \$45.3 million held in WMC RETL LLC, a wholly-owned subsidiary of the Company, was paid off. Accordingly, the RETL 2019 Trust is no longer consolidated.

CSMC Trust 2014-USA

The Company together with other related party entities own more than 50% of the controlling class of CSMC Trust 2014-USA ("CSMC USA"). As of December 31, 2022, the Company held an 8.8% interest in the trust certificates issued by CSMC USA (F Class) with an outstanding principal balance of \$14.9 million. The Company performs ongoing reassessment of its CMBS VIE holdings for potential consolidation of the securitized trust in which it owns a portion of the controlling class. Since the ownership of the controlling financial interest is held within a related party group, the Company must determine whether it is the primary beneficiary under the related party tie-breaker rule. As a result of the Company's evaluation, it was determined that the Company is the primary beneficiary of

CSMC USA, and effective on August 1, 2020, consolidated CSMC USA. The Company's investment in the trust certificate of CSMC USA (F Class) was eliminated in the consolidation. The CSMC USA holds a commercial loan secured by a first mortgage lien on the borrowers' fee and leasehold interests in a portion of a super-regional mall. The outstanding principal balance on this commercial loan is \$1.4 billion as of December 31, 2022. The loan's has a stated maturity date is September 11, 2025 and bears a fixed interest rate of 4.38%. The Company elected the fair value option for the commercial loan as well as the associated securitized debt.

In December 2020, the commercial loan held by CSMC USA was amended to an interest only payment through maturity. As part of the modification a Cash Management Forbearance Agreement was entered into by the special servicer and the borrower, which required both increased reporting requirements and monthly net cash remittance.

Consolidated securitized commercial loan trusts and commercial loan trust

The two commercial consolidated trusts, CSMC USA and RSBC Trust collectively held two commercial loans as of December 31, 2022. The following table presents a summary of the assets and liabilities of the two consolidated trusts included in the Consolidated Balance Sheets as of December 31, 2022 and December 31, 2021 (dollars in thousands):

	December 31, 2022	December 31, 2021
Restricted cash.....	\$ 248	\$ 260
Securitized commercial loans, at fair value	1,085,103	1,355,808
Commercial Loans, at fair value.....	14,362	14,362
Interest receivable.....	5,311	5,290
Total assets	<u>\$ 1,105,024</u>	<u>\$ 1,375,720</u>
Securitized debt, at fair value	\$ 1,077,611	\$ 1,344,370
Interest payable.....	5,164	5,164
Accounts payable and accrued expenses	9	9
Other liabilities.....	248	260
Total liabilities.....	<u>\$ 1,083,032</u>	<u>\$ 1,349,803</u>

The Company's risk with respect to its investment in the securitized commercial loan trust is limited to its direct ownership in the trust. The commercial loan held by the consolidated securitized commercial loan trust is held solely to satisfy the liabilities of the trust, and creditors of the trust have no recourse to the general credit of the Company. The securitized commercial loan of trust can only be used to satisfy the obligations of that trust. The Company is not contractually required to provide, and has not provided any additional financial support to the securitized commercial trust for the years ended December 31, 2022 and December 31, 2021.

The following table presents the components of the carrying value of the securitized commercial loans and commercial loans as of December 31, 2022 and December 31, 2021 (dollars in thousands):

	CSMC USA Trust Securitized Commercial Loan, at Fair Value		RSBC Trust Commercial Loans, at Fair Value		Commercial Loans, at Fair Value	
	December 31, 2022	December 31, 2021	December 31, 2022	December 31, 2021	December 31, 2022	December 31, 2021
Principal balance	\$ 1,385,591	\$ 1,385,591	\$ 14,362	\$ 14,362	\$ 157,205	\$ 177,797
Unamortized discount	(84,132)	(110,770)	—	—	—	—
Amortized cost	1,301,459	1,274,821	14,362	14,362	157,205	177,797
Gross unrealized gains	—	80,987	—	—	—	—
Gross unrealized losses	(216,356)	—	—	—	(81,565)	(61,587)
Fair value.....	<u>\$ 1,085,103</u>	<u>\$ 1,355,808</u>	<u>\$ 14,362</u>	<u>\$ 14,362</u>	<u>\$ 75,640</u>	<u>\$ 116,210</u>

Non-performing commercial loans

The following table presents the aging of the Commercial Loans as of December 31, 2022 (dollars in thousands):

	Commercial Loans		
	No of Loans	Principal	Fair Value
Current	5	\$ 81,567	\$ 81,225
1-30 days	—	—	—
31-60 days	—	—	—
61-90 days	—	—	—
90+ days	1	90,000	8,777
Total	<u>6</u>	<u>\$ 171,567</u>	<u>\$ 90,002</u>

Commercial real estate owned

Hotel REO

In February 2022, the Company along with other Hotel REO investors, sold the unencumbered hotel property which was foreclosed on in the third quarter of 2021 for \$55.9 million. The Company and the other investors fully recovered their aggregate initial investment of \$42.0 million. The Company and the other investors recognized a gain on sale of approximately \$12.2 million.

REO Activity

In December 2022, the Company received payments for its remaining four REO properties of \$1.1 million and transferred one Residential Whole Loan property into REO for its carrying value of \$2.3 million.

Note 7—Financings

Repurchase agreements

The Company has primarily financed its investment acquisitions with repurchase agreements. The repurchase agreements bear interest at a contractually agreed-upon rate and historically had terms ranging from one month to 12 months. The Company's repurchase agreement borrowings are accounted for as secured borrowings when the Company maintains effective control of the financed assets. Under these repurchase agreements, the respective counterparties retain the right to determine the fair value of the underlying collateral. A reduction in the value of pledged assets normally requires the Company to post additional securities as collateral, pay down borrowings or establish cash margin accounts with the counterparties in order to re-establish the agreed-upon collateral requirements, is referred to as a margin call. The inability of the Company to post adequate collateral for a margin call by a counterparty, in a time frame as short as the close of the same business day, could result in a condition of default under the Company's repurchase agreements, thereby enabling the counterparty to liquidate the collateral pledged by the Company, which may have a material adverse effect on the Company's financial position, results of operations and cash flows.

In order to manage the severe market conditions and the resulting large margin demands from lenders and pressure on the Company's liquidity, the Company entered into three longer term financing arrangements to reduce its exposure to short-term financings with daily mark-to-market exposure. Below is a summary of each of these financing arrangements.

Residential whole loan facility

On November 5, 2021, the Company entered into a further amendment of its Residential Whole Loan Facility. The amended facility has a stated capacity of \$500.0 million and bears an interest rate to LIBOR plus 2.00%, with a LIBOR floor of 0.25%. The facility is available to finance five types of residential mortgages: Non-Agency mortgage loans, Non-QM loans, investor loans, re-performing and non-performing loans. The advance rates may differ by type of loan, but for performing Non-QM loans the advance rate is 90%. The facility had an original maturity date of November 4, 2022. The facility is a mark to market margin facility; however, the margin requirement is only triggered if the fair value of the collateral declines to below the aggregate outstanding principal amount of the collateral.

On November 9, 2022, the facility was extended to mature on October 25, 2023. It bears interest at a rate of SOFR plus 2.25%, with a SOFR floor of 0.25%.

The Company finances its Non-QM residential whole loans held in RMI 2015 Trust under this facility. As of December 31, 2022, the Company had outstanding borrowings of \$3.6 million. The borrowing is secured by against Non-QM Residential Whole Loans with a fair value of \$3.2 million and one REO property with a carrying value of \$2.3 million as of December 31, 2022.

Non-Agency CMBS and Non-Agency RMBS facility

On May 5, 2021, the Company amended its Non-Agency CMBS and Non-Agency RMBS financing facility to, among other things, extend the facility for an additional 12 months and reduce the interest rate. The amended facility has improved advance rates and bears interest at a rate of three-month LIBOR plus 2.00%.

On May 2, 2022, the facility was extended to mature on May 2, 2023. It bears interest at a rate of SOFR plus 2.00%. As of December 31, 2022, the outstanding balance under this facility was \$91.1 million. The borrowing is secured by investments with a fair market value of \$129.9 million as of December 31, 2022.

Commercial whole loan facility

On May 5, 2021, the Company amended its Commercial Whole Loan Facility to, among other things, convert the term to a 12-month facility with a stated capacity of up to \$100 million. The facility has a 12-month extension option, subject to the lender's consent.

On November 9, 2022, the facility was extended to mature on November 3, 2023. It bears interest at a rate of SOFR plus 2.25%. As of December 31, 2022, the outstanding balance under its facility was \$48.0 million. The borrowing is secured by the performing commercial loans that are held in CRE LLC with an estimated fair market value of \$66.9 million as of December 31, 2022.

Financial metrics

Certain of the Company's financing arrangements provide the counterparty with the right to terminate the agreement and accelerate amounts due under the associated agreement if the Company does not maintain financial metrics. Although specific to each financing arrangement, typical financial metrics include minimum equity and liquidity requirements, leverage ratios, and performance triggers. In addition, some of the financing arrangements contain cross-default features, whereby default under an agreement with one lender simultaneously causes default under agreements with other lenders. The Company was in compliance with the terms of such financial tests as of December 31, 2022.

As of December 31, 2022, the Company had borrowings under six of its master repurchase agreements. The following table summarizes certain characteristics of the Company's repurchase agreements at December 31, 2022 and December 31, 2021 (dollars in thousands):

Securities Pledged	December 31, 2022			December 31, 2021		
	Repurchase Agreement Borrowings	Weighted Average Interest Rate on Borrowings Outstanding at end of period	Weighted Average Remaining Maturity (days)	Repurchase Agreement Borrowings	Weighted Average Interest Rate on Borrowings Outstanding at end of period	Weighted Average Remaining Maturity (days)
Short-term borrowings:						
Agency RMBS	\$ 293	4.78%	32	\$ 976	1.02%	58
Non-Agency RMBS ⁽¹⁾	48,237	7.50%	26	38,354	2.94%	4
Residential Whole Loans ⁽²⁾	—	—%	0	1,439	2.57%	5
Residential Bridge Loans ⁽²⁾	—	—%	0	4,368	2.61%	5
Commercial Loans ⁽²⁾	—	—%	0	6,463	3.20%	5
Other securities	1,776	7.09%	17	2,457	3.50%	18
Total short-term borrowings	50,306	7.47%	26	54,057	2.92%	6
Long-term borrowings:						
<i>Non-Agency CMBS and Non-Agency RMBS Facility</i>						
Non-Agency CMBS ⁽¹⁾	55,154	6.30%	122	59,802	2.14%	125
Non-Agency RMBS	19,129	6.30%	122	15,632	2.14%	125
Other securities	16,863	6.30%	122	27,506	2.22%	125
Subtotal	91,146	6.30%	122	102,940	2.16%	125
<i>Residential Whole Loan Facility</i>						
Residential Whole Loans ⁽²⁾	3,633	6.66%	298	396,531	2.25%	308
<i>Commercial Whole Loan Facility</i>						
Commercial Loans	48,032	6.13%	307	63,661	2.27%	268
Total long-term borrowings	142,811	6.25%	189	563,132	2.24%	270
Repurchase agreements borrowings	\$ 193,117	6.57%	146	\$ 617,189	2.30%	247
Less unamortized debt issuance costs	—	N/A	N/A	—	N/A	N/A
Repurchase agreements borrowings, net	\$ 193,117	6.57%	146	\$ 617,189	2.30%	247

(1) Includes repurchase agreement borrowings on securities eliminated upon VIE consolidation.

(2) Repurchase agreement borrowings on loans owned are through trust certificates. The trust certificates are eliminated in consolidation.

At December 31, 2022 and December 31, 2021, repurchase agreements collateralized by investments had the following remaining maturities:

(dollars in thousands)	December 31, 2022	December 31, 2021
1 to 29 days	\$ 50,013	\$ 53,081
30 to 59 days	293	370
60 to 89 days	—	606
Greater than or equal to 90 days	142,811	563,132
Total	\$ 193,117	\$ 617,189

At December 31, 2022, the following table reflects amounts of collateral at risk under its repurchase agreements greater than 10% of the Company's equity with any counterparty (dollars in thousands):

Counterparty	December 31, 2022		
	Amount of Collateral at Risk, at fair value	Weighted Average Remaining Maturity (days)	Percentage of Stockholders' Equity
Credit Suisse AG, Cayman Islands Branch.....	\$ 51,542	171	54.4%
Citigroup Global Markets Inc.	40,235	122	42.4%

Collateral for borrowings under repurchase agreements

The following table summarizes the Company's collateral positions, with respect to its borrowings under repurchase agreements at December 31, 2022 and December 31, 2021 (dollars in thousands):

	December 31, 2022			December 31, 2021		
	Assets Pledged	Accrued Interest	Assets Pledged and Accrued Interest	Assets Pledged	Accrued Interest	Assets Pledged and Accrued Interest
Assets pledged for borrowings under repurchase agreements:						
Agency RMBS, at fair value.....	\$ 249	\$ —	\$ 249	\$ 1,172	\$ 19	\$ 1,191
Non-Agency CMBS, at fair value ⁽¹⁾	83,925	483	84,408	107,624	504	108,128
Non-Agency RMBS, at fair value.....	104,487	533	105,020	66,555	343	66,898
Residential Whole Loans, at fair value ⁽²⁾	3,229	3	3,232	453,447	2,674	456,121
Residential Bridge Loans ⁽²⁾	—	—	—	5,207	91	5,298
Commercial Loans, at fair value ⁽²⁾	66,864	362	67,226	101,459	360	101,819
Other securities, at fair value.....	27,262	78	27,340	51,648	100	51,748
Cash ⁽³⁾	3,410	—	3,410	3,151	—	3,151
Total.....	<u>\$ 289,426</u>	<u>\$ 1,459</u>	<u>\$ 290,885</u>	<u>\$ 790,263</u>	<u>\$ 4,091</u>	<u>\$ 794,354</u>

(1) Includes securities eliminated upon VIE consolidation.

(2) Loans owned through trust certificates are pledged as collateral. The trust certificates are eliminated upon consolidation.

(3) Cash posted as collateral is included in "Due from counterparties" in the Company's Consolidated Balance Sheets.

A reduction in the value of pledged assets typically results in the repurchase agreement counterparties initiating a margin call. At December 31, 2022 and December 31, 2021, investments held by counterparties as security for repurchase agreements totaled approximately \$286.0 million and approximately \$787.1 million, respectively. Cash collateral held by counterparties at December 31, 2022 and December 31, 2021 was approximately \$3.4 million and \$3.2 million, respectively. Cash posted by repurchase agreement counterparties at December 31, 2022 and December 31, 2021 was \$300 thousand and \$0, respectively.

Convertible Senior Unsecured Notes

6.75% Convertible Senior Unsecured Notes due 2024

In September 2021, the Company issued \$86.3 million aggregate principal of convertible senior unsecured notes due 2024 (the "2024 Notes") for net proceeds of \$83.3 million. Interest on the 2024 Notes is paid semiannually. The 2024 Notes are convertible into, at the Company's election, cash, shares of the Company's common stock or a combination of both, subject to the satisfaction of certain conditions and during specified periods. The conversion rate is subject to adjustment upon the occurrence of certain specified events and the holders may require the Company to repurchase all or any portion of their notes for cash equal to 100% of the principal amount of the 2024 Notes, plus accrued and unpaid interest, if the Company undergoes a fundamental change as specified in the supplemental indenture for the 2024 Notes. The initial conversion rate was 33.7952 shares of common stock per \$1,000 principal amount of notes and represented a conversion price of \$29.59 per share of common stock. The 2024 Notes mature on September 15, 2024, unless earlier converted, redeemed or repurchased by the holders pursuant to their terms, and are not redeemable by the Company except during the final three months prior to maturity.

6.75% Convertible Senior Unsecured Notes due 2022

At December 31, 2021, the Company had \$37.7 million aggregate principal amount of the convertible senior unsecured notes due 2022 (the "2022 Notes") outstanding. Interest on the 2022 Notes is paid semiannually. The 2022 Notes were repaid in full upon their maturity on October 3, 2022.

The 2022 Notes Exchanges and Repurchases

During the quarters ended December 31, 2021, September 30, 2021, and March 31, 2021, the Company repurchased \$8.0 million, \$122.6 million, and \$6.7 million aggregate principal amount of the 2022 Notes at an approximate 1% premium to par value, 2.8% discount to par value, and 6.3% discount to par value, respectively, plus accrued and unpaid interest.

During the quarters ended September 30, 2022, June 30, 2022, and March 31, 2022, the Company repurchased \$1.0 million, \$7.2 million, and \$3.4 million aggregate principal amount of the 2022 Notes at par value, 0.6% premium to par value, and 0.8% premium to par value, respectively, plus accrued and unpaid interest.

During the quarter ended December 31, 2022, the Company repaid the remaining \$26.0 million aggregate principal amount of its 2022 Notes at par value, plus accrued and unpaid interest, upon their maturity.

Securitized Debt

Arroyo Trust 2019-2

In May 2019, the Company completed a residential mortgage-backed securitization comprised of \$945.5 million of Non-QM Residential Whole Loans, issuing \$919.0 million of mortgage-backed notes. The Company did not elect the fair value option for these notes and accordingly they are recorded at their principal balance less unamortized deferred financing costs and classified in “Securitized debt, net” in the Consolidated Balance Sheets. The following table summarizes the issued Arroyo Trust’s residential mortgage pass-through certificates at December 31, 2022 (dollars in thousands):

Classes	Principal Balance	Coupon	Carrying Value	Contractual Maturity
Offered Notes:				
Class A-1	\$ 168,131	3.3%	\$ 168,131	4/25/2049
Class A-2	9,017	3.5%	9,017	4/25/2049
Class A-3	14,286	3.8%	14,286	4/25/2049
Class M-1	25,055	4.8%	25,055	4/25/2049
Subtotal	\$ 216,489		\$ 216,489	
Less: Unamortized Deferred Financing Costs	N/A		2,604	
Total	\$ 216,489		\$ 213,885	

The Company retained the non-offered securities in the securitization, which include the class B, Class A-IO-S and Class XS certificates. These non-offered securities were eliminated in consolidation. The securitized debt of the Arroyo Trust 2019 can only be settled with the residential loans that serve as collateral for the securitized debt and is non-recourse to the Company. At December 31, 2022, residential whole loans, with an outstanding principal balance of approximately \$243.3 million, served as collateral for the Arroyo Trust 2019-2’s securitized debt. The Company may redeem the offered notes on or after the earlier of (i) the three-year anniversary of the closing date or (ii) the date on which the aggregate collateral balance is 20% of the original principal balance. The notes are redeemable at their face value plus accrued interest.

Arroyo Trust 2020-1

In June 2020, the Company completed a residential mortgage-backed securitization comprised of \$355.8 million of Non-QM Residential Whole Loans, issuing \$341.7 million of mortgage-backed notes. The Company did not elect the fair value option for these notes and accordingly they are recorded at their principal balance less unamortized deferred financing cost and classified in “Securitized debt, net” in the Consolidated Balance Sheets. The following table summarizes the issued Arroyo Trust 2020-1’s residential mortgage pass-through certificates at December 31, 2022 (dollars in thousands):

Classes	Principal Balance	Coupon	Carrying Value	Contractual Maturity
Offered Notes:				
Class A-1A	\$ 74,425	1.7%	\$ 74,425	3/25/2055
Class A-1B	8,831	2.1%	8,831	3/25/2055
Class A-2	13,518	2.9%	13,518	3/25/2055
Class A-3	17,963	3.3%	17,963	3/25/2055
Class M-1	11,739	4.3%	11,739	3/25/2055
Subtotal	\$ 126,476		\$ 126,476	
Less: Unamortized Deferred Financing Costs	N/A		1,542	
Total	\$ 126,476		\$ 124,934	

The Company retained the non-offered securities in the securitization, which include the Class B, Class A-IO-S and Class XS certificates. These non-offered securities were eliminated in consolidation. The securitized debt of the Arroyo Trust 2020 can only be settled with the residential loans that serve as collateral for the securitized debt and is non-recourse to the Company. At December 31, 2022, residential whole loans, with an outstanding principal balance of approximately \$140.5 million serve as collateral for the Arroyo Trust 2020’s securitized debt. The Company may redeem the offered notes on or after the earlier of (i) the three-year anniversary of the closing date or (ii) the date on which the aggregate collateral balance is equal to or less than 30% of the original principal balance. The notes are redeemable at their face value plus accrued interest.

Arroyo Trust 2022-1

In February 2022, the Company completed a residential-mortgage backed securitization comprised of \$432.0 million of Non-QM residential whole loans, issuing \$398.9 million of mortgage-backed notes. The Company has chosen to make the fair value election pursuant to ASC 825 (accounting guidance for the fair value of CFE's) for the debt and accordingly the bonds are recorded at fair value in the Consolidated Balance Sheets with the periodic changes in fair value are recorded in current period earnings in the Consolidated Statements of Operations as a component of "Unrealized loss, net."

The following table summarizes the issued Arroyo Trust 2022-1's residential mortgage pass-through certificates at December 31, 2022 (dollars in thousands):

Classes	Principal Balance	Coupon	Fair Value	Contractual Maturity
Offered Notes:				
Class A-1A	\$ 212,307	2.5%	\$ 194,438	12/25/2056
Class A-1B	82,942	3.3%	73,259	12/25/2056
Class A-2	21,168	3.6%	17,054	12/25/2056
Class A-3	28,079	3.7%	21,308	12/25/2056
Class M-1	17,928	3.7%	12,160	12/25/2056
Total	<u>\$ 362,424</u>		<u>\$ 318,219</u>	

The Company retained the non-offered securities in the securitization, which include the Class B, Class A-IO-S, and Class XS certificates. These non-offered securities were eliminated in consolidation. The securitized debt of the Arroyo Trust 2022-1 can only be settled with the residential loans that serve as collateral for the securitized debt and is non-recourse to the Company. At December 31, 2022, residential whole loans with an outstanding principal balance of approximately \$394.7 million serve as collateral for the Arroyo Trust 2022-1's securitized debt. The Company may redeem the offered notes on or after the earlier of (i) the three-year anniversary of the closing date or (ii) the date on which the aggregate collateral balance is equal to or less than 30% of the original principal balance. The notes are redeemable at their fair value plus accrued interest.

Arroyo Trust 2022-2

In July 2022, the Company completed a residential-mortgage backed securitization comprised of \$402.2 million of Non-QM residential whole loans, issuing \$351.9 million of mortgage-backed notes. The Company has chosen to make the fair value election pursuant to ASC 825 (accounting guidance for the fair value of CFE's) for the debt and accordingly the bonds are recorded at fair value in the Consolidated Balance Sheets with the periodic changes in fair value are recorded in current period earnings in the Consolidated Statements of Operations as a component of "Unrealized loss, net."

The following table summarizes the issued Arroyo Trust 2022-2's residential mortgage pass-through certificates at December 31, 2022 (dollars in thousands):

Classes	Principal Balance	Coupon	Fair Value	Contractual Maturity
Offered Notes:				
Class A-1	\$ 267,533	5.0%	\$ 260,217	7/25/2057
Class A-2	22,773	5.0%	21,983	7/25/2057
Class A-3	27,749	5.0%	26,619	7/25/2057
Class M-1	17,694	5.0%	15,216	7/25/2057
Total	<u>\$ 335,749</u>		<u>\$ 324,035</u>	

The Company retained the non-offered securities in the securitization, which include the Class B-1, Class B-2, Class B-3, Class A-IO-S, and Class XS certificates. These non-offered securities were eliminated in consolidation. The securitized debt of the Arroyo Trust 2022-2 can only be settled with the residential loans that serve as collateral for the securitized debt and is non-recourse to the Company. At December 31, 2022, residential whole loans with an outstanding principal balance of approximately \$385.0 million serve as collateral for the Arroyo Trust 2022-2's securitized debt. The Company may redeem the offered notes on or after the earlier of (i) the three-year anniversary of the closing date or (ii) the date on which the aggregate collateral balance is equal to or less than 30% of the original principal balance. The notes are redeemable at their fair value plus accrued interest.

Commercial mortgage-backed notes

CSMC 2014 USA

The following table summarizes CSMC 2014 USA's commercial mortgage pass-through certificates at December 31, 2022 (dollars in thousands):

Classes	Principal Balance	Coupon	Fair Value	Contractual Maturity
Class A-1.....	\$ 120,391	3.3%	\$ 108,591	9/11/2025
Class A-2.....	531,700	4.0%	477,678	9/11/2025
Class B.....	136,400	4.2%	115,782	9/11/2025
Class C.....	94,500	4.3%	76,304	9/11/2025
Class D.....	153,950	4.4%	113,229	9/11/2025
Class E.....	180,150	4.4%	99,858	9/11/2025
Class F.....	153,600	4.4%	77,242	9/11/2025
Class X-1 ⁽¹⁾	n/a	0.7%	7,430	9/11/2025
Class X-2 ⁽¹⁾	n/a	0.2%	1,497	9/11/2025
	<u>\$ 1,370,691</u>		<u>\$ 1,077,611</u>	

(1) Class X-1 and Class X-2 are interest-only classes with notional balances of \$652.1 million and \$733.5 million as of December 31, 2022, respectively.

At December 31, 2022, the Company owned a portion of the class F certificates with an outstanding principal balance of \$14.9 million, which is eliminated in consolidation. The remaining CSMC USA debt that we elected the fair value option had a fair value of \$1.1 billion, and is recorded in "Securitized debt, net" in the Consolidated Balance Sheets. Of the remaining outstanding principal balance of \$1.4 billion, \$186.0 million is owned by related parties and \$1.2 billion is owned by third parties. The securitized debt of the CSMC USA can only be settled with the commercial loan with an outstanding principal balance of approximately \$1.4 billion at December 31, 2022, that serves as collateral for the securitized debt and is non-recourse to the Company. The Company has chosen to make the fair value election pursuant to ASC 825 for the debt and accordingly the periodic changes in fair value are recorded in current period earnings in the Consolidated Statements of Operations as a component of "Unrealized loss, net."

Note 8—Derivative Instruments

The Company's derivatives may include interest rate swaps, swaptions, options, futures contracts, TBAs, Agency and Non-Agency Interest-Only Strips that are classified as derivatives, credit default swaps, and total return swaps.

The following table summarizes the Company's derivative instruments at December 31, 2022 and December 31, 2021 (dollars in thousands):

Derivative Instrument	Accounting Designation	Consolidated Balance Sheets Location	December 31, 2022		December 31, 2021	
			Notional Amount	Fair Value	Notional Amount	Fair Value
Interest rate swaps, asset.....	Non-Hedge	Derivative assets, at fair value	\$ 60,000	\$ 1	\$ —	\$ —
Credit default swaps, asset.....	Non-Hedge	Derivative assets, at fair value	—	—	2,030	105
Total derivative instruments, assets.....				<u>1</u>		<u>105</u>
Interest rate swaps, liability.....	Non-Hedge	Derivative liability, at fair value	98,000	(61)	22,000	(38)
Credit default swaps, liability.....	Non-Hedge	Derivative liability, at fair value	—	—	4,140	(564)
Total derivative instruments, liabilities.....				<u>(61)</u>		<u>(602)</u>
Total derivative instruments, net.....				<u>\$ (60)</u>		<u>\$ (497)</u>

The following table summarizes the effects of the Company's derivative positions, including Interest-Only Strips characterized as derivatives and TBAs, which are reported in "Gain (loss) on derivative instruments, net" in the Consolidated Statements of Operations for the years ended December 31, 2022, December 31, 2021 and December 31, 2020 (dollars in thousands):

Description	Realized Gain (Loss), net		Return (Recovery) of Basis	Mark-to-Market	Contractual interest income (expense), net	Total
	Other Settlements / Expirations	Variation Margin Settlement				
Year ended December 31, 2022						
Interest rate swaps	\$ (3,371)	\$ 13,765	\$ —	\$ 3,348	\$ 628	\$ 14,370
Interest rate swaptions	(161)	—	—	—	—	(161)
Interest-Only Strips— accounted for as derivatives	—	—	(102)	(242)	151	(193)
Credit default swaps	(242)	—	—	393	—	151
TBAs	2,051	—	—	—	—	2,051
Total	<u>\$ (1,723)</u>	<u>\$ 13,765</u>	<u>\$ (102)</u>	<u>\$ 3,499</u>	<u>\$ 779</u>	<u>\$ 16,218</u>
Year ended December 31, 2021						
Interest rate swaps	\$ —	\$ 490	\$ —	\$ (38)	\$ 109	\$ 561
Interest-Only Strips— accounted for as derivatives	—	—	(300)	(206)	394	(112)
Credit default swaps	64	—	—	36	—	100
Total	<u>\$ 64</u>	<u>\$ 490</u>	<u>\$ (300)</u>	<u>\$ (208)</u>	<u>\$ 503</u>	<u>\$ 549</u>
Year ended December 31, 2020						
Interest rate swaps	\$ (262)	\$ (179,759)	\$ 262	\$ (2,515)	\$ (1,395)	\$ (183,669)
Interest rate swaptions	80	—	—	—	—	80
Interest-Only Strips— accounted for as derivatives	(940)	—	(1,096)	(532)	1,324	(1,244)
Credit default swaps	(9,534)	—	—	(1,834)	—	(11,368)
TBAs	(2,430)	—	—	928	—	(1,502)
Total	<u>\$ (13,086)</u>	<u>\$ (179,759)</u>	<u>\$ (834)</u>	<u>\$ (3,953)</u>	<u>\$ (71)</u>	<u>\$ (197,703)</u>

At December 31, 2022 and December 31, 2021, the Company had cash pledged as collateral for derivatives of approximately \$3.2 million and approximately \$1.4 million respectively, which is reported in "Due from counterparties" in the Consolidated Balance Sheets.

Interest rate swaps

The Company uses interest rate swaps to mitigate its exposure to higher short-term interest rates in connection with its repurchase agreements. Interest rate swaps generally involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the interest rate swap without exchange of the underlying notional amount. Notwithstanding the foregoing, in order to manage its hedge position with regard to its liabilities, the Company on occasion will enter into interest rate swaps which involve the receipt of fixed-rate amounts from a counterparty in exchange for the Company making variable-rate payments over the life of the interest rate swap without exchange of the underlying notional amount. The Company also enters into forward starting swaps to help mitigate the effects of changes in interest rates on a portion of its borrowings under repurchase agreements. The Company generally enters into MAC (Market Agreed Coupon) interest rate swaps in which it may receive or make a payment at the time of entering such interest rate swap to compensate for the out of the market nature of such interest rate swap. Similar to all other interest rate swaps, these interest rate swaps are also subject to margin requirements.

The Company has not elected to account for its interest rate swaps as "hedges" under GAAP, accordingly the change in fair value of the interest rate swaps not designated in hedging relationships are recorded together with periodic net interest settlement amounts in "Gain (loss) on derivatives instruments, net" in the Consolidated Statements of Operations.

The following table provides additional information on the Company's fixed-pay interest rate swap as of December 31, 2022 (dollars in thousands):

Fixed Pay Interest Rate Swap Remaining Term	December 31, 2022			
	Notional Amount	Average Fixed Pay Rate	Average Floating Receive Rate	Average Maturity (Years)
Greater than 1 year and less than 3 years	\$ 60,000	1.4%	2.0%	1.3
Greater than 3 years and less than 5 years.....	70,000	1.4%	1.8%	4.1
Greater than 5 years	28,000	1.7%	3.6%	9.0
Total	<u>\$ 158,000</u>	<u>1.4%</u>	<u>2.2%</u>	<u>3.9</u>

To-Be-Announced securities

The Company purchased and sold TBAs during the year ended December 31, 2022, as shown in the table below. There were no open TBA positions as of December 31, 2022 and December 31, 2021.

The following table presents additional information about the Company's contracts to purchase and sell TBAs for the year ended December 31, 2022 (dollars in thousands):

	Notional Amount	Additions	Settlement, Termination, Expiration or Exercise	Notional Amount
	December 31, 2021		December 31, 2022	
Purchase of TBAs	\$ —	\$ 600,000	\$ (600,000)	\$ —
Sale of TBAs.....	\$ —	\$ 600,000	\$ (600,000)	\$ —

Interest-Only strips

The Company also invests in Interest-Only Strips. In determining the classification of its holdings of Interest-Only Strips, the Company evaluates the securities to determine if the nature of the cash flows has been altered from that of the underlying mortgage collateral. Generally, Interest-Only Strips for which the security represents a strip off of a mortgage pass through security will be considered a hybrid instrument classified as an MBS investment in the Consolidated Balance Sheets utilizing the fair value option. Alternatively, those Interest-Only Strips, for which the underlying mortgage collateral has been included into a structured security that alters the cash flows from the underlying mortgage collateral, are accounted for as derivatives at fair value with changes recognized in "Gain (loss) on derivative instruments, net" in the Consolidated Statements of Operations, along with any interest received. The carrying value of these Interest-Only Strips is included in "Agency mortgage-backed securities, at fair value" in the Consolidated Balance Sheets.

Credit default swaps

The Company currently has outstanding credit default swaps. Under these instruments, the buyer makes a monthly premium payment over the term of the contract in exchange for the seller making a payment for losses of the reference securities, upon the occurrence of a specified credit event.

Note 9—Offsetting Assets and Liabilities

The following tables present information about certain assets and liabilities that are subject to master netting agreements (or similar agreements) and can potentially be offset in the Company's Consolidated Balance Sheets at December 31, 2022 and December 31, 2021 (dollars in thousands):

Description	December 31, 2022					
	Gross Amounts	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets		Net Amount
				Financial Instruments ⁽¹⁾	Cash Collateral ⁽¹⁾	
Derivative Assets						
Agency and Non-Agency Interest-Only Strips, accounted for as derivatives included in MBS.....	\$ 714	\$ —	\$ 714	\$ (196)	\$ —	\$ 518
Derivative asset, at fair value ⁽²⁾⁽³⁾	1	—	1	(1)	—	—
Total assets	<u>\$ 715</u>	<u>\$ —</u>	<u>\$ 715</u>	<u>\$ (197)</u>	<u>\$ —</u>	<u>\$ 518</u>
Derivative Liabilities and Repurchase Agreements						
Derivative liability, at fair value ⁽²⁾⁽³⁾	\$ 61	\$ —	\$ 61	\$ (1)	\$ (60)	\$ —
Repurchase Agreements ⁽⁴⁾	193,117	—	193,117	(193,073)	(44)	—
Total liability	<u>\$ 193,178</u>	<u>\$ —</u>	<u>\$ 193,178</u>	<u>\$ (193,074)</u>	<u>\$ (104)</u>	<u>\$ —</u>

- (1) Amounts disclosed in the financial instruments column of the tables above represent securities, whole loans and securitized commercial loan collateral pledged and derivative assets that are available to be offset against liability balances associated with repurchase agreement and derivative liabilities. Amounts disclosed in the cash collateral column of the tables above represents amounts pledged or received as collateral against derivative transactions.
- (2) Derivative asset, at fair value includes interest rate swaps.
- (3) Cash collateral pledged against the Company's derivative counterparties was approximately \$3.2 million as of December 31, 2022.
- (4) The carrying value of investments pledged against the Company's repurchase agreements was approximately \$286.0 million as of December 31, 2022.

Description	December 31, 2021					
	Gross Amounts	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets		Net Amount
				Financial Instruments ⁽¹⁾	Cash Collateral ⁽¹⁾	
Derivative Assets						
Agency and Non-Agency Interest-Only						
Strips, accounted for as derivatives						
included in MBS.....	\$ 1,058	\$ —	\$ 1,058	\$ (1,058)	\$ —	\$ —
Derivative asset, at fair value ⁽²⁾	105	—	105	(105)	—	—
Total derivative assets	\$ 1,163	\$ —	\$ 1,163	\$ (1,163)	\$ —	\$ —
Derivative Liabilities and Repurchase Agreements						
Derivative liability, at fair value ⁽²⁾⁽³⁾	\$ 602	\$ —	\$ 602	\$ (105)	\$ (497)	\$ —
Repurchase Agreements ⁽⁴⁾	617,189	—	617,189	(617,189)	—	—
Total liability	\$ 617,791	\$ —	\$ 617,791	\$ (617,294)	\$ (497)	\$ —

- (1) Amounts disclosed in the financial instruments column of the tables above represent securities, whole l and securitized commercial loan collateral pledged and derivative assets that are available to be offset against liability balances associated with repurchase agreement and derivative liabilities. Amounts disclosed in the cash collateral column of the tables above represents amounts pledged or received as collateral against derivative transactions.
- (2) Derivative asset, at fair value and Derivative liability, at fair value credit default swaps.
- (3) Cash collateral pledged against the Company's derivative counterparties was approximately \$1.4 million as of December 31, 2021.
- (4) The carrying value of investments pledged against the Company's repurchase agreements was approximately \$787.1 million as of December 31, 2021.

Certain of the Company's repurchase agreement and derivative transactions are governed by underlying agreements that generally provide for a right of set-off in the event of default or in the event of a bankruptcy of either party to the transaction.

Note 10—Related Party Transactions

Management Agreement

In connection with the Company's initial public offering ("IPO") in May 2012, the Company entered into a management agreement (the "Management Agreement") with the Manager, which describes the services to be provided by the Manager and compensation for such services. The Manager is responsible for managing the Company's operations, including: (i) performing all of its day-to-day functions; (ii) determining investment criteria in conjunction with the Board of Directors; (iii) sourcing, analyzing and executing investments, asset sales and financings; (iv) performing asset management duties; and (v) performing financial and accounting management, subject to the direction and oversight of the Company's Board of Directors. Pursuant to the terms of the Management Agreement, the Manager is paid a management fee equal to 1.50% per annum of the Company's stockholders' equity (as defined in the Management Agreement), calculated and payable (in cash) quarterly in arrears. For purposes of calculating the management fee, "stockholders' equity" means the sum of the net proceeds from any issuances of the Company's 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, calculated in accordance with GAAP, at the end of the most recently completed fiscal quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount paid for repurchases of the Company's shares of common stock, excluding any unrealized gains or losses on our investments and derivatives and other non-cash items, (excluding other than temporary impairment) that have impacted stockholders' equity as reported in the Company's consolidated financial statements prepared in accordance with GAAP, regardless of whether such items are included in other comprehensive income or loss, or in net income, and excluding one-time events pursuant to changes in GAAP and certain other non-cash charges after discussions between the Manager and the Company's independent directors and after approval by a majority of the Company's independent directors. However, if the Company's stockholders' equity for any given quarter is negative based on the calculation described above, the Manager will not be entitled to receive any management fee for that quarter.

In addition, the Company may be required to reimburse the Manager for certain expenses as described below, and shall reimburse the Manager for the compensation paid to the Company's chief financial officer, controller and their staff. Expense reimbursements to the Manager are made in cash on a regular basis. The Company's reimbursement obligation is not subject to any dollar limitation. Because the Manager's personnel perform certain legal, accounting, due diligence tasks and other services that outside professionals or outside consultants otherwise would perform, the Manager may be paid or reimbursed for the documented cost of performing such tasks, provided that such costs and reimbursements are in amounts which are no greater than

those which would be payable to outside professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arm's-length basis.

The Management Agreement may be amended, supplemented or modified by agreement between the Company and the Manager. The Management Agreement expires on May 16, 2023. It is automatically renewed for a one year term on May 15, 2022 and automatically renews on each subsequent May 15th unless previously terminated as described below. The Company's independent directors review the Manager's performance and any fees payable to the Manager annually and, the Management Agreement may be terminated annually upon the affirmative vote of at least two-thirds (2/3) of the Company's independent directors, based upon: (i) the Manager's unsatisfactory performance that is materially detrimental to the Company; or (ii) the Company's determination that any fees payable to the Manager are not fair, subject to the Manager's right to prevent such termination due to unfair fees by accepting a reduction of management fees agreed to by at least two-thirds (2/3) of the Company's independent directors. The Company will provide the Manager 180 days prior notice of any such termination. Unless terminated for cause, the Company will pay the Manager a termination fee equal to three times the average annual management fee earned by the Manager during the prior 24-month period immediately preceding the date of termination, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination.

The Company may also terminate the Management Agreement at any time, without the payment of any termination fee, with 30 days prior written notice from the Company's Board of Directors for cause, which will be determined by at least two-thirds (2/3) of the Company's independent directors, which is defined as: (i) the Manager's continued material breach of any provision of the Management Agreement (including the Manager's failure to comply with the Company's investment guidelines); (ii) the Manager's fraud, misappropriation of funds, or embezzlement against the Company; (iii) the Manager's gross negligence in the performance of its duties under the Management Agreement; (iv) the occurrence of certain events with respect to the bankruptcy or insolvency of the Manager, including an order for relief in an involuntary bankruptcy case or the Manager authorizing or filing a voluntary bankruptcy petition; (v) the Manager is convicted (including a plea of *nolo contendere*) of a felony; or (vi) the dissolution of the Manager.

For the years ended December 31, 2022, December 31, 2021 and December 31, 2020, the Company incurred \$3.9 million, \$5.9 million and \$4.5 million in management fees, respectively. The Manager waived the management fee for three months from March 2020 through May 2020 because of the unprecedented market disruption and dislocation across fixed income markets surrounding the uncertainty related to the COVID-19 pandemic. In December 2021, the Manager agreed to voluntarily waive 25% of its management fee solely for the duration of calendar year 2022 in order to support the earnings potential of the Company and its transition to a residential focused investment portfolio. Future waivers, if any, will be at the Manager's discretion.

In addition to the management fee, the Company is also responsible for reimbursing the Manager for certain expenses paid by the Manager on behalf of the Company, as defined in the Management Agreement. For the years ended December 31, 2022, December 31, 2021 and December 31, 2020, the Company recorded expenses included in General and Administrative Expenses totaling approximately \$604 thousand, \$1.9 million and \$1.7 million, respectively, related to reimbursable employee costs. Any such expenses incurred by the Manager and reimbursed by the Company, including the employee compensation expense, are typically included in the Company's General and Administrative Expense in the Consolidated Statements of Operations. At December 31, 2022 and December 31, 2021, approximately \$3.9 million and approximately \$1.5 million, respectively, for management fees incurred but not yet paid was included in "Payable to affiliate" in the Consolidated Balance Sheets. In addition, at December 31, 2022 and December 31, 2021, approximately \$86 thousand and approximately \$457 thousand, respectively, of reimbursable costs incurred but not yet paid was included in "Payable to affiliate" in the Consolidated Balance Sheets.

Note 11—Share-Based Payments

The Company's ability to grant new equity-based awards under the Company's existing equity incentive plans expired on May 9, 2022. At the Annual Meeting of Stockholders held on June 24, 2022, the Company's stockholders approved the Western Asset Mortgage Capital Corporation 2022 Omnibus Incentive Plan and the Western Asset Mortgage Capital Corporation 2022 Manager Omnibus Incentive Plan (collectively, the "2022 Plans"). The 2022 Plans provide for the issuance of options (including non-statutory stock options and incentive stock options), stock appreciation rights (referred to as SARs), restricted stock, restricted stock units (referred to as RSUs), stock bonuses, other stock based awards and cash awards.

The aggregate maximum number of shares of the Company's common stock available for future issuances under the 2022 Plans is 1,000,000 shares, which was reduced to 100,000 shares following the completion of the reverse stock split. The Manager and the officers, employees, non-employee directors, independent contractors, and consultants of the Company or any affiliate of the Company, including any individuals who are employees of the Manager or one of the Manager's affiliates, are eligible to participate in the 2022 Plans, provided that they have been selected by the Plan Administrator.

Under the Equity Plan, the Company made the following grants during the years ended December 31, 2022 and December 31, 2021:

On June 25, 2021, the Company granted a total of 81,160 restricted stock units (20,290 per each independent director), or 8,116 shares (2,029 per each independent director) on a post reverse stock split basis, under the Equity Plan to the Company's four independent directors. These restricted stock units vested in full on June 25, 2022, the first anniversary of the grant date, and will be settled in shares of the Company's common stock upon a separation from service with the Company.

On June 24, 2022, the Company granted a total of 217,040 restricted stock units (54,260 per each independent director) or 21,704 shares (5,426 per each independent director) on a post reverse stock split basis, to each of the Company's four independent directors. These restricted stock units will vest in full on June 24, 2023, the first anniversary of the grant date, and will be settled in shares of the Company's common stock upon each of the independent director's separation from service with the Company.

On June 30, 2022, the Company granted 200,000 restricted stock units, or 20,000 restricted stock units on a post reverse stock split basis under the Western Asset Mortgage Capital Corporation 2022 Omnibus Incentive Plan to the Company's Chief Financial Officer. These restricted stock units will vest in equal installments on the first and second anniversary of the grant date.

During the years ended December 31, 2022, December 31, 2021 and December 31, 2020, 11,716, 13,782 and 6,748 restricted stock units vested, respectively. The Company recognized stock-based compensation expense of approximately \$435 thousand, \$618 thousand and \$699 thousand for the years ended December 31, 2022, December 31, 2021 and December 31, 2020, respectively. In addition, the Company had unamortized compensation expense of \$298 thousand and \$211 thousand for equity awards at December 31, 2022 and December 31, 2021, respectively.

Holders of restricted stock units are entitled to receive dividends (or dividend equivalent payments) and distributions that become payable on the restricted stock units during the restricted period. Dividend equivalent payments allocable to restricted stock units are deemed to purchase additional phantom shares of the Company's common stock that are credited to each participant's deferral account. The award agreements include restrictions whereby the restricted stock units cannot be sold, assigned, transferred, pledged, hypothecated or otherwise disposed of prior to the lapse of restrictions under the respective award agreement. The restrictions lapse on the unvested restricted stock units awarded when vested, subject to the grantee's continuing to provide services to the Company as of the vesting date. Unvested restricted stock units and rights to dividends thereon are forfeited upon termination of the grantee.

The following is a summary of restricted stock units vesting dates as of December 31, 2022 and December 31, 2021:

Vesting Date	December 31, 2022 Shares Vesting	December 31, 2021 Shares Vesting
March 2022	—	3,600
June 2022	—	8,116
June 2023	31,704	—
June 2024	10,000	—
	41,704	11,716

The following table presents information with respect to the Company's restricted stock units for the years ended December 31, 2022 and December 31, 2021:

	December 31, 2022		December 31, 2021	
	Restricted Stock Units	Weighted Average Grant Date Fair Value ⁽¹⁾	Restricted Stock Units	Weighted Average Grant Date Fair Value ⁽¹⁾
Outstanding at beginning of period	114,825	\$ 131.85	102,556	\$ 140.99
Granted ⁽²⁾	48,971	12.61	14,815	50.72
Cancelled/forfeited	—	—	(2,546)	27.50
Outstanding at end of period	163,796	\$ 96.20	114,825	\$ 131.85
Unvested at end of period.....	41,704	\$ 12.52	11,716	\$ 56.19

(1) The grant date fair value of restricted stock unit awards is based on the closing market price of the Company's common stock at the grant date.

(2) Includes 7,267 shares and 6,698 restricted stock units attributed to dividends on restricted stock units for the years ended December 31, 2022 and December 31, 2021, respectively.

Note 12—Stockholders' Equity

Reverse stock split

On June 30, 2022, the Company announced that its board of directors approved a one-for-ten reverse stock split of the Company's outstanding shares of common stock. The one-for-ten reverse stock split was effected on July 11, 2022, which reduced the total number of authorized shares of common stock from 500,000,000 to 50,000,000 shares, resulting in the number of common shares outstanding reducing from 60,380,105 to 6,038,012. The par value per share of our common stock remained unchanged at \$0.01. All per share amounts and common shares outstanding have been adjusted on a retroactive basis to reflect the Company's one-for-ten reverse stock split.

Our stockholders' equity, in the aggregate, remains unchanged. Per share net income or loss increased because there are fewer shares of common stock outstanding. The common stock held in treasury was reduced in proportion to the Reverse Stock Split Ratio. There were no other accounting consequences, including changes to the amount of stock-based compensation expense to be recognized in any period, that arose as a result of the reverse stock split. No fractional shares were issued in connection with the reverse stock split. Instead, each stockholder holding fractional shares was entitled to receive, in lieu of such fractional shares, cash in an amount determined based on the closing price of the Company's common stock the business day prior to the Effective Date. The reverse stock split applied to all of the Company's outstanding shares of common stock and did not affect any stockholder's ownership percentage of shares of the Company's common stock, except for immaterial changes resulting from the payment of cash for fractional shares.

At-The-Market Program

In March 2017, the Company entered into an equity distribution agreement with JMP Securities LLC, which was amended on June 5, 2020, under which the Company may offer and sell up to \$100 million of shares of common stock in an At-The-Market equity offering. During the years ended December 31, 2022 and December 31, 2021, the Company did not sell shares under this agreement.

Stock Repurchase Program

In December 2021, The Company extended its share repurchase program as authorized by its Board of Directors. Under the extended program, the Company is permitted to repurchase up to 300,000 shares of its common stock through December 31, 2023. Any purchases made pursuant to the program will be made in the open market, in privately negotiated transactions, or pursuant to any trading plan that may be adopted in accordance with Rules 10b5-1 and 10b-18 of the Securities and Exchange Commission Act of 1934, as amended. The authorization does not obligate the Company to acquire any particular amount of common shares, or any shares at all, and the program may be suspended or discontinued at the Company's discretion without prior notice.

During the year ended December 31, 2022, the Company did not repurchase any shares under the stock repurchase program.

Dividends

The following table presents cash dividends declared and paid by the Company on its common stock, not adjusted on a retroactive basis to reflect the Company's one-for-ten reverse stock split to align with 1099-DIV per share amounts as reported.

<u>Declaration Date</u>	<u>Record Date</u>	<u>Payment Date</u>	<u>Amount per Share</u>	<u>Tax Characterization</u>
2022				
December 21, 2022	January 3, 2023	January 26, 2023	\$ 0.40	Ordinary income ⁽¹⁾
September 22, 2022	October 3, 2022	October 26, 2022	\$ 0.40	Ordinary income
June 21, 2022	July 1, 2022	July 25, 2022	\$ 0.04	Ordinary income
March 23, 2022	April 4, 2022	April 26, 2022	\$ 0.04	Ordinary income
2021				
December 21, 2021	December 31, 2021	January 26, 2022	\$ 0.06	Ordinary income ⁽²⁾
September 23, 2021	October 4, 2021	October 26, 2021	\$ 0.06	Return of capital
June 22, 2021	July 2, 2021	July 26, 2021	\$ 0.06	Return of capital
March 23, 2021	April 2, 2021	April 26, 2021	\$ 0.06	Return of capital

(1) The cash distributions made on January 26, 2023, with a record date of January 3, 2023, are treated as received by stockholders on January 26, 2023 and taxable in calendar year 2023.

(2) The cash distributions made on January 26, 2022, with a record date of December 31, 2021, were treated as received by stockholders on January 26, 2022 and taxable in calendar year 2022 as return of capital.

Note 13—Net Income (Loss) per Common Share

The table below presents basic and diluted net income (loss) per share of common stock using the two-class method for the years ended December 31, 2022, December 31, 2021 and December 31, 2020 (dollars, other than shares and per share amounts, in thousands):

	<u>For the year ended December 31, 2022</u>	<u>For the year ended December 31, 2021</u>	<u>For the year ended December 31, 2020</u>
<i>Numerator:</i>			
Net loss attributable to common stockholders and participating securities for basic and diluted earnings per share.....	\$ (89,079)	\$ (48,953)	\$ (328,354)
Less:			
Dividends and undistributed earnings allocated to participating securities.....	<u>95</u>	<u>89</u>	<u>36</u>
Net income loss allocable to common stockholders—basic and diluted.....	<u>\$ (89,174)</u>	<u>\$ (49,042)</u>	<u>\$ (328,390)</u>
<i>Denominator:</i>			
Weighted average common shares outstanding for basic earnings per share.....	<u>6,037,164</u>	<u>6,074,714</u>	<u>5,741,138</u>
Weighted average common shares outstanding for diluted earnings per share.....	<u>6,037,164</u>	<u>6,074,714</u>	<u>5,741,138</u>
Basic loss per common share	<u>\$ (14.77)</u>	<u>\$ (8.07)</u>	<u>\$ (57.20)</u>
Diluted loss per common share	<u>\$ (14.77)</u>	<u>\$ (8.07)</u>	<u>\$ (57.20)</u>

For the years ended December 31, 2022, December 31, 2021 and December 31, 2020, the Company excluded the effects of the convertible senior unsecured notes from the computation of diluted earnings per share since the average market value per share of the Company's common stock was below the exercise price of the convertible senior unsecured notes.

Note 14—Income Taxes

As a REIT, the Company is not subject to federal income tax to the extent that it makes qualifying distributions to its stockholders and satisfies on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income and stock ownership tests.

Based on the Company's analysis of any potential uncertain income tax positions, the Company concluded that it does not have any uncertain tax positions that meet the recognition or measurement criteria as of December 31, 2022. The Company files U.S. federal and state income tax returns. As of December 31, 2022, U.S. federal tax returns filed by the Company for 2021, 2020 and 2019 and state tax returns filed for 2021, 2020, 2019, 2018 and 2017 are open for examination pursuant to relevant statutes of limitation. In the event that the Company incurs income tax related interest and penalties, the Company's policy is to classify them as a component of its provision for income taxes.

Income Tax Provision

Subject to the limitation under the REIT asset test rules, the Company is permitted to own up to 100% of the stock of one or more TRS. Currently, the Company owns one TRS that is taxable as a corporation and is subject to federal, state and local income tax on its net income at the applicable corporate rates. The TRS, which was formed in Delaware on July 28, 2014, is a limited liability company and a wholly-owned subsidiary of the Company. For the years ended December 31, 2022, December 31, 2021 and December 31, 2020, the Company recorded a federal and state tax provision of approximately \$171 thousand, \$99 thousand, and \$396 thousand, respectively.

The following table summarizes the Company's income tax provision for the years ended December 31, 2022, December 31, 2021 and December 31, 2020 (dollars in thousands):

	<u>For the year ended December 31, 2022</u>	<u>For the year ended December 31, 2021</u>	<u>For the year ended December 31, 2020</u>
Current Tax Provision (Benefit)			
Federal.....	\$ 171	\$ 55	\$ 527
State.....	<u>—</u>	<u>44</u>	<u>(452)</u>
Total Current Provision for Income Taxes, net.....	171	99	75
Deferred Provision (Benefit) for Income Taxes			
Federal.....	<u>—</u>	<u>—</u>	<u>(85)</u>
State.....	<u>—</u>	<u>—</u>	<u>406</u>
Total Deferred Benefit for Income Taxes, net.....	<u>—</u>	<u>—</u>	<u>321</u>
Total Income Tax Provision, net.....	<u>\$ 171</u>	<u>\$ 99</u>	<u>\$ 396</u>

Deferred Tax Asset

As of December 31, 2022 and December 31, 2021, the Company recorded a deferred tax asset of approximately \$13.5 million and \$12.2 million, respectively, relating to capital loss carryforward and temporary differences as a result of the timing of income recognition of certain investments held in the TRS. The capital loss carryforwards may only be recognized to the extent of capital gains. There is uncertainty as to the TRS ability to recognize capital gains in the future. As a result, the Company has concluded it is more likely than not the deferred tax asset will not be realized and has recorded a full valuation allowance.

In addition, the REIT generated net operating losses (“NOLs”) during the year ended December 31, 2021 related to ordinary losses on its MBS portfolio and it generated NOLs for the years ended December 31, 2020 and December 31, 2017, related to its swap terminations, and for its California return a portion of the NOLs is apportioned to the TRS. The Company recorded a deferred state tax asset of \$14.5 million and \$14.7 million in the REIT and \$1.6 million and \$1.6 million in the TRS as of December 31, 2022 and December 31, 2021, respectively. The TRS can carryback the NOLs generated during the years ended December 31, 2020 and December 31, 2017 to each of the two preceding years to request a refund for taxes paid. As of December 31, 2022 and December 31, 2021, the Company has concluded it is more likely than not the deferred tax asset relating to the NOLs will not be realized and it has recorded a combined valuation allowance of \$16.1 million and \$16.3 million, respectively.

The following tables disclose the components of the Company’s deferred tax asset and deferred tax liability at December 31, 2022 and 2021 (dollars in thousands):

Deferred Tax Asset	December 31, 2022	December 31, 2021
Net operating loss available for carry-back and carry-forward ⁽¹⁾	\$ 16,111	\$ 16,302
Net capital loss carry-forward ⁽¹⁾	7,929	10,384
Investments	5,576	1,849
Deferred tax asset.....	29,616	28,535
Allowance	(29,616)	(28,535)
Net deferred tax asset.....	<u>\$ —</u>	<u>\$ —</u>
Deferred Tax Liability	December 31, 2022	December 31, 2021
Net operating loss available for carry-back and carry-forward.....	\$ —	\$ —
Net deferred tax liability	<u>\$ —</u>	<u>\$ —</u>

(1) Net operating loss available for carry-forward begin to expire in 2037. Net capital loss available for carry-forward begin to expire in 2023.

Reconciliation of Tax Rate to Effective Tax Rate

The Company’s effective tax rate differs from its combined federal and state income tax rate primarily due to the deduction of dividends distributions to be paid under Code Section 857(a). The reconciliation of these rates are as follows:

	For the year ended December 31, 2022	For the year ended December 31, 2021
Federal statutory rate.....	21.0%	21.0%
State statutory rate, net of federal benefit.....	0.4%	(6.9)%
Other	—%	0.2%
Change in valuation allowance	(3.3)%	16.3%
REIT earnings not subject to corporate taxes.....	(18.3)%	(30.8)%
Effective Tax Rate.....	<u>(0.2)%</u>	<u>(0.2)%</u>

Note 15—Commitments and Contingencies

From time to time, the Company may become involved in various claims, regulatory actions and legal actions arising in the ordinary course of business. Management is not aware of any material contingencies at December 31, 2022 and December 31, 2021, respectively.

Note 16—Subsequent Events

On February 3, 2023, the CRE 3 loan was sold to an unaffiliated third party equal to its recorded value at December 31, 2022 of \$8.8 million.

Western Asset Mortgage Capital Corporation and Subsidiaries
Schedule IV
Mortgage Loans on Real Estate
As of December 31, 2022

\$ in thousands Asset Type	Description	Number of Loans	Interest Rate	Maturity Date	Periodic Payment Terms ⁽¹⁾	Prior Liens	Face Amount of Mortgages	Carrying Amount of Mortgages ⁽⁴⁾	Principal Amount of Loans Subject to Delinquent Principal or Interest
Residential Whole Loans and Residential Bridge Loans									
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$0 - \$249,999	518	Hybrid ARM 2.5% to 6.4%	11/01/2041 to 06/01/2052	P&I	\$ —	\$ 78,456	\$ 77,462	\$ —
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$250,000 - \$499,999	637	Hybrid ARM 2.7% to 5.9%	01/01/2042 to 02/01/2055	P&I	—	203,089	199,462	338
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$500,000 - \$749,999	231	Hybrid ARM 2.5% to 6.3%	04/01/2043 to 11/01/2055	P&I	—	130,112	126,555	1,623
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$750,000 - \$999,999	89	Hybrid ARM 3.4% to 6.2%	05/01/2043 to 06/01/2052	P&I	—	69,656	67,470	790
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$1,000,000 - \$1,249,999	31	Hybrid ARM 3.5% to 5.8%	09/01/2043 to 05/01/2052	P&I	—	32,683	31,534	937
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$1,250,000 - \$1,499,999	24	Hybrid ARM 3.4% to 5.6%	12/01/2041 to 05/01/2052	P&I	—	29,867	28,605	1,321
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$1,500,000 and above	17	Hybrid ARM 2.9% to 6.1%	08/01/2044 to 04/01/2052	P&I	—	29,348	28,684	—
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$0 - \$249,999	464	Fixed 3.7% to 7.1%	07/01/2026 to 06/01/2052	P&I	—	77,047	69,854	—
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$250,000 - \$499,999	481	Fixed 2.9% to 7.2%	09/01/2026 to 06/01/2052	P&I	—	161,520	145,326	980
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$500,000 - \$749,999	252	Fixed 2.5% to 6.1%	11/01/2033 to 06/01/2052	P&I	—	147,193	131,322	641
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$750,000 - \$999,999	106	Fixed 2.9% to 6.4%	11/01/2033 to 06/01/2052	P&I	—	88,557	79,389	—
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$1,000,000 - \$1,249,999	49	Fixed 2.9% to 5.9%	11/01/2048 to 06/01/2052	P&I	—	53,027	47,986	2,108
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$1,250,000 - \$1,499,999	26	Fixed 2.7% to 6.3%	02/01/2036 to 05/01/2052	P&I	—	33,542	30,117	—
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$1,500,000 and above	18	Fixed 3.1% to 5.7%	10/01/2048 to 06/01/2052	P&I	—	31,203	27,378	—
Fixed Rate Residential Bridge Loans Held in Securitization Trusts	Original Loan Balance \$0 - \$249,999	1	Fixed 9.8% to 12.3%	12/31/2022	Interest Only ⁽²⁾	—	75	68	75

\$ in thousands Asset Type	Description	Number of Loans	Interest Rate	Maturity Date	Periodic Payment Terms ⁽¹⁾	Prior Liens	Face Amount of Mortgages	Carrying Amount of Mortgages ⁽⁴⁾	Principal Amount of Loans Subject to Delinquent Principal or Interest	
Fixed Rate Residential Bridge Loans Held in Securitization Trusts	Original Loan Balance \$250,000 - \$499,999	1	Fixed 11.3%	12/31/2022	Interest Only ⁽²⁾	—	420	378	420	
Fixed Rate Residential Bridge Loans Held in Securitization Trusts	Original Loan Balance \$750,000 - \$999,999	3	Fixed 8.5% to 10%	12/31/2022	Interest Only ⁽²⁾	—	2,671	2,404	2,671	
Total Residential Whole Loans and Residential Bridge Loans						\$	—	\$ 1,168,466	\$ 1,093,994	\$ 11,904
Commercial Loans										
Commercial Loan Held in Securitization Trust	Original Loan Balance \$32,000,000	1	LIBOR + 4.1%	01/06/2023	Interest Only ⁽³⁾	\$ —	\$ 14,362	\$ 14,362	\$ —	
Commercial Loan	Original Loan Balance \$90,000,000	1	LIBOR + 9.25%	06/29/2021	Interest Only ⁽³⁾	—	90,000	8,777	90,000	
Commercial Loan	Original Loan Balance \$40,000,000	1	SOFR + 3.38%	08/06/2025	Interest Only ⁽³⁾	—	22,204	22,050	—	
Commercial Loan	Original Loan Balance \$13,206,521	1	LIBOR + 3.75%	11/06/2023	Interest Only ⁽³⁾	—	13,207	13,151	—	
Commercial Loan	Original Loan Balance \$24,534,783	1	LIBOR + 3.75%	11/06/2023	Interest Only ⁽³⁾	—	24,535	24,433	—	
Commercial Loan	Original Loan Balance \$7,258,696	1	LIBOR + 3.75%	11/06/2023	Interest Only ⁽³⁾	—	7,259	7,229	—	
Total Commercial Loans						\$	—	\$ 171,567	\$ 90,002	\$ 90,000
Securitized Commercial Loans										
Commercial Loan Held in Securitization Trust	Original Loan Balance \$1,400,000,000	1	Fixed 4.38%	09/15/2025	Interest Only ⁽³⁾	—	1,385,591	1,085,103	—	
Total Securitized Commercial Loans						\$	—	\$ 1,385,591	\$ 1,085,103	\$ —
Total Residential and Commercial Loans						\$	—	\$ 2,725,624	\$ 2,269,099	\$ 101,904

(1) Principal and interest ("P&I")

(2) Residential Bridge Loans are mainly interest only loans with a balloon payment at maturity.

(3) The borrower may prepay the commercial loan in whole or in part at any time in accordance with the terms of the loan agreement.

(4) The carrying value of the reflects the fair value of the mortgage loans.

(5) On February 3, 2023, this loan was sold to an independent third party for its fair value as of December 31, 2022.

Reconciliation of Carrying Value of Mortgage Loans on Real Estate:

	2022	2021	2020
Beginning balance.....	\$ 2,515,310	\$ 2,938,556	\$ 2,691,532
Additions during period:			
New mortgage loans.....	411,919	427,848	113,340
Unrealized gains.....	—	100,598	—
Realized gains.....	91	35	—
Capitalized interest.....	96	485	829
Mortgage loan of consolidated VIE.....	—	—	1,245,287
Deductions during period:			
Collections of principal.....	239,398	872,612	713,854
Transfer to REO.....	2,256	30,751	419
Amortization of premium and (discounts), net.....	(20,701)	(15,053)	(4,805)
Unrealized losses.....	425,527	63,661	97,089
Sales of mortgage loans.....	11,736	—	144,259
Realized losses.....	101	241	10,812
Mortgage loan of deconsolidated VIE.....	—	—	150,804
Balance at end of period.....	<u>\$ 2,269,099</u>	<u>\$ 2,515,310</u>	<u>\$ 2,938,556</u>

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) that are designed to provide reasonable assurance that information required to be disclosed 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 SEC’s rules and forms, and that such information is accumulated and communicated to our Chief Executive Officer and Chief Financial Officer as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, we recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and therefore we are required to apply judgment in evaluating the cost-benefit relationship of possible controls and procedures.

The Company’s Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of December 31, 2022.

(b) Management’s Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, the Company’s Chief Executive Officer and Chief Financial Officer and effected by the Company’s Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, and includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Management of the Company has assessed the effectiveness of the Company’s internal control over financial reporting as of December 31, 2022. In making its assessment of internal control over financial reporting, management used the criteria described in “Internal Control—Integrated Framework” (2013 framework) issued by the Committee of Sponsoring Organizations of the Treadway Commission, (“COSO”). Based on this evaluation, management concluded that the Company’s internal control over financial reporting was effective as of December 31, 2022 based on criteria in “Internal Control—Integrated Framework” (2013 framework) issued by the COSO.

The effectiveness of the Company’s internal control over financial reporting as of December 31, 2022 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

(c) Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting during the three months ended December 31, 2022, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

ITEM 9C. DISCLOSURE REGARDING FOREIGN JURISDICTION THAT PREVENT INSPECTIONS

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The information regarding the Company's directors, executive officers and certain other matters required by Item 401 of Regulation S-K is incorporated herein by reference to the Company's proxy statement relating to its annual meeting of stockholders to be held on or about June 24, 2023 (the "Proxy Statement"), to be filed with the SEC within 120 days after December 31, 2022.

The information regarding compliance with Section 16(a) of the Exchange Act required by Item 405 of Regulation S-K is incorporated herein by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2022.

The information regarding the Company's Code of Business Conduct and Ethics required by Item 406 of Regulation S-K is incorporated herein by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2022.

The information regarding certain matters pertaining to the Company's corporate governance required by Item 407(c)(3), (d)(4) and (d)(5) of Regulation S-K is incorporated by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2022.

ITEM 11. EXECUTIVE COMPENSATION

The information regarding executive compensation and other compensation related matters required by Items 402 and 407(e)(4) and (e)(5) of Regulation S-K is incorporated herein by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2022.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The tables on equity compensation plan information and beneficial ownership of the Company required by Items 201(d) and 403 of Regulation S-K are incorporated herein by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2022.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information regarding transactions with related persons, promoters and certain control persons and director independence required by Items 404 and 407(a) of Regulation S-K is incorporated herein by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2022.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information concerning principal accounting fees and services and the Audit Committee's pre-approval policies and procedures required by Item 9(e) of Schedule 14A is incorporated herein by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2022.

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULE

Documents filed as part of this report:

- 1) Financial Statements

WESTERN ASSET MORTGAGE CAPITAL CORPORATION

Consolidated Balance Sheets as of December 31, 2022 and 2021	65
Consolidated Statements of Operations for the years ended December 31, 2022, December 31, 2021 and December 31, 2020	67
Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2022, December 31, 2021 and December 31, 2020	68
Consolidated Statements of Cash Flow for the years ended December 31, 2022, December 31, 2021 and December 31, 2020	69
Notes to Consolidated Financial Statements	71
Schedule IV—Mortgage Loans on Real Estate.....	107

Financial Statements Schedules other than the one listed above are omitted because the required information is not applicable or deemed not material, or the required information is presented in the financial statements and/or in the notes to financial statements.

2) Exhibits

The following exhibits are filed as part of this report.

Exhibit No.	Description
3.1*	Amended and restated certificate of incorporation of Western Asset Mortgage Capital Corporation, incorporated by reference to Exhibit 3.1 to Amendment No. 10 Form S-11 (Registration Statement No. 333-159962), filed May 8, 2012
3.2*	Amendment to the Amended and restated certificate of incorporation of Western Asset Mortgage Capital Corporation, dated June 3, 2016, incorporated by reference to Exhibit 3.3 to the Annual report on Form 10-K, filed March 7, 2017.
3.3*	Amendment to the amended and restated certificate of incorporation of Western Asset Mortgage Capital Corporation, dated July 8, 2022, incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K, filed on July 11, 2022.
3.4*	Amended and restated bylaws of Western Asset Mortgage Capital Corporation, incorporated by reference to Exhibit 3.2 to Amendment No. 10 Form S-11 (Registration Statement No. 333-159962), filed May 8, 2012.
4.1*	Specimen Common Stock Certificate of Western Asset Mortgage Capital Corporation, incorporated by reference to Exhibit 4.1 to Amendment No. 10 Form S-11 (Registration Statement No. 333-159962), filed May 8, 2012
4.2*	Indenture, dated as of October 2, 2017, between Western Asset Mortgage Capital Corporation and Wells Fargo Bank, National Association, incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K, filed on October 3, 2017.
4.3*	First Supplemental Indenture, dated as of October 2, 2017, between Western Asset Mortgage Capital Corporation and Wells Fargo Bank, National Association, incorporated by reference to Exhibit 4.2 to the Current Report on Form 8-K, filed on October 3, 2017.
4.4*	Form of 6.75% Convertible Senior Notes due 2022 (attached as Exhibit A to the First Supplemental Indenture filed as Exhibit 4.3 hereto), incorporated by reference to Exhibit 4.3 to the Current Report on Form 8-K, filed on October 3, 2017.
4.5*	Second Supplemental Indenture, dated as of September 14, 2021, between Western Asset Mortgage Capital Corporation and Wells Fargo Bank, National Association, incorporated by reference to Exhibit 4.2 to the Current Report on Form 8-K, filed on October 3, 2017.
4.6*	Form of 6.75% Convertible Senior Notes due 2024 (attached as Exhibit A to the Second Supplemental Indenture filed as Exhibit 4.5 hereto), incorporated by reference to Exhibit 4.3 to the Current Report on Form 8-K, filed on October 3, 2017.
10.1*	Amendment to the Management Agreement between Western Asset Mortgage Capital Corporation and Western Asset Management Company, dated August 3, 2016, incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q, filed August 5, 2016.
10.2*	Form of Warrant, incorporated by reference to Exhibit 10.2 to Amendment No. 9 Form S-11 (Registration Statement No. 333-159962), filed April 30, 2012.
10.3*	Management Agreement, dated May 9, 2012, between Western Asset Mortgage Capital Corporation and Western Asset Management Company, incorporated by reference to Exhibit 10.4 to the Quarterly Report on Form 10-Q, filed August 14, 2012.
10.4*	Registration Rights Agreement, dated May 15, 2012, among Western Asset Mortgage Capital Corporation, Western Asset Management Company and certain individual holders named therein, incorporated by reference to Exhibit 10.5 to the Quarterly Report on Form 10-Q, filed August 14, 2012.
10.5*+	Western Asset Mortgage Capital Corporation Equity Plan, incorporated by reference to Exhibit 10.5 to Amendment No. 9 Form S-11 (Registration Statement No. 333-159962), filed April 30, 2012.
10.6*+	Western Asset Mortgage Capital Corporation Manager Equity Plan, incorporated by reference to Exhibit 10.6 to Amendment No. 9 Form S-11 (Registration Statement No. 333-159962), filed April 30, 2012.
10.7*	Form of Indemnification Agreement between Western Asset Mortgage Capital Corporation and a director, incorporated by reference to Exhibit 10.7 to Amendment No. 9 Form S-11 (Registration Statement No. 333-159962), filed April 30, 2012.
10.8*+	Restricted Stock Award Agreement, dated May 15, 2012, for Western Asset Management Company, incorporated by reference to Exhibit 10.9 to the Quarterly Report on Form 10-Q, filed August 14, 2012.
10.9*+	Form of Restricted Stock Award Agreement for independent directors, incorporated by reference to Exhibit 10.2 to the Form S-8 dated May 15, 2012 (File No. 1-35543).
10.10*	Equity Distribution Agreement, dated March 6, 2017, among Western Asset Mortgage Capital Corporation, Western Asset Management Company and JMP Securities LLC, incorporated by reference to Exhibit 1.1 to the Current Report on Form 8-K, filed March 9, 2017.
10.11*	Amendment No. 1 to the Equity Distribution Agreement, dated June 5, 2020, among Western Asset Mortgage Capital Corporation, Western Asset Management Company, LLC and JMP Securities LLC, incorporated by reference to Exhibit 1.1 to the Current Report on Form 8-K, filed June 5, 2020.
23.1	Consent of Independent Registered Public Accounting Firm
31.1	Rule 13a-14(a) / 15d-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a) / 15d-14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer
101.INS	Inline XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (formatted as Inline XBRL with applicable taxonomy extension information contained in Exhibits 101)

* Fully or partly previously filed.

+ Management contract or compensatory plan arrangement.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

WESTERN ASSET MORTGAGE CAPITAL CORPORATION

By: /s/ BONNIE M. WONGTRAKOOL
Bonnie M. Wongtrakool
Chief Executive Officer and Director
(Principal Executive Officer)

March 10, 2023

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ BONNIE M. WONGTRAKOOL
Bonnie M. Wongtrakool
Chief Executive Officer and Director
(Principal Executive Officer)

March 10, 2023

By: /s/ ROBERT W. LEHMAN
Robert W. Lehman
Chief Financial Officer

March 10, 2023

By: /s/ JAMES W. HIRSCHMANN III
James W. Hirschmann III
Director

March 10, 2023

By: /s/ EDWARD D. FOX JR.
Edward D. Fox Jr.
Director

March 10, 2023

By: /s/ M. CHRISTIAN MITCHELL
M. Christian Mitchell
Director

March 10, 2023

By: /s/ RANJIT M. KRIPALANI
Ranjit M. Kripalani
Director

March 10, 2023

By: /s/ LISA G. QUATEMAN
Lisa G. Quateman
Director

March 10, 2023

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Board of Directors

Edward D. Fox

Chairman and Chief Executive Officer of Vantage Property Investors, LLC

James W. Hirschmann III

Chairman of the Board of the Company and Chief Executive Officer of our Manager

Ranjit M. Kripalani

Consultant

M. Christian Mitchell

Corporate Board Member and Advisor

Lisa G. Quateman

Chief Executive Officer of Voyager Advisory LLC

Bonnie M. Wongtrakool

Chief Executive Officer of the Company and Global Head of ESG Investments and a Portfolio Manager of our Manager

Executive Officers

Bonnie M. Wongtrakool

Chief Executive Officer of the Company and Global Head of ESG Investments and a Portfolio Manager of our Manager

Greg Handler

Chief Investment Officer of the Company and Head of our Manager's Mortgage and Consumer Credit Group

Sean O. Johnson

Deputy Chief Investment Officer of the Company and Portfolio Manager in our Manager's Mortgage and Consumer Credit Group

Robert W. Lehman

Chief Financial Officer of the Company

Elliott Neumayer

Chief Operating Officer of the Company and Product Specialist and Head of Mortgage-Related Business of our Manager

Stockholder Information

Corporate Office

385 East Colorado Boulevard
Pasadena, California 91101
Phone: 626.844.9400

Common Stock Listing

New York Stock Exchange
Symbol: WMC

Transfer Agent

American Stock Transfer & Trust Company, LLC
Operations Center
6201 15th Avenue
Brooklyn, NY 11219

Investor Relations Contact

Larry Clark
Financial Profiles, Inc.
Phone: 310.622.8223
lclark@finprofiles.com

