

ANWORTH MORTGAGE ASSET CORP

Form 424B5

January 15, 2015

[Table of Contents](#)

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Registration No. 333-187385**

**The information in this preliminary prospectus supplement is not complete and may be changed. This preliminary prospectus supplement and the accompanying prospectus are not an offer to sell these securities and are not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION, DATED JANUARY 15, 2015**

**Preliminary Prospectus Supplement**

**(To Prospectus dated April 8, 2013)**

**Shares**

**Anworth Mortgage Asset Corporation**

**7.625% Series C Cumulative Redeemable Preferred Stock**

**(Liquidation Preference \$25.00 per Share)**

We are offering \_\_\_\_\_ shares of our 7.625% Series C Cumulative Redeemable Preferred Stock, par value \$0.01 per share (which we refer to as the Series C Preferred Stock). We will pay cumulative dividends on the Series C Preferred Stock, from and including the date of original issuance, in the amount of \$1.90625 per share each year, which is equivalent to 7.625% of the \$25.00 liquidation preference per share. Dividends on the Series C Preferred Stock will be payable quarterly in arrears, beginning on April 15, 2015. Our other series of preferred stock outstanding as of the date of this prospectus supplement are 1,009,640 shares of our 6.25% Series B Cumulative Preferred Stock (which we refer to as our Series B Preferred Stock), with a liquidation preference of \$25.00 per share, and 1,919,378 shares of our 8.625% Series A Cumulative Preferred Stock (which we refer to as our Series A Preferred Stock), with a liquidation preference of \$25.00 per share. The Series C Preferred Stock will rank on parity with our Series A Preferred Stock and Series B Preferred Stock.

On or after January \_\_, 2020, we may, at our option, redeem the Series C Preferred Stock, in whole or in part, at a redemption price of \$25.00 per share, plus any accrued and unpaid dividends to, but not including, the redemption date. In addition, upon the occurrence of a Change of Control (as defined herein) after which neither we nor the

acquiring or surviving entity has a class of common securities listed for trading on a United States national securities exchange (including the Nasdaq Stock Market), we may, at our option, redeem the Series C Preferred Stock, in whole or in part, within 120 days after the first date on which such Change of Control occurred at a redemption price of \$25.00 per share, plus any accrued and unpaid dividends to, but not including, the redemption date. See Description of Series C Preferred Stock Redemption beginning on page S-33 of this prospectus supplement.

Upon the occurrence of a Change of Control, each holder of Series C Preferred Stock will have the right (subject to our election to redeem the Series C Preferred Stock, in whole or in part, as described above, prior to the Change of Control Conversion Date (as defined herein)) to convert some or all of the shares of Series C Preferred Stock held by such holder on the Change of Control Conversion Date into a number of shares of our common stock per share of Series C Preferred Stock equal to the lesser of:

the quotient obtained by dividing (i) the sum of the \$25.00 liquidation preference per share of Series C Preferred Stock plus the amount of any accrued and unpaid dividends to, but not including, the Change of Control Conversion Date (unless the Change of Control Conversion Date is after a Dividend Record Date (as defined herein) and prior to the corresponding Dividend Payment Date (as defined herein) for the Series C Preferred Stock, in which case no additional amount for such accrued and unpaid dividends will be included in this sum) by (ii) the Common Stock Price (as defined herein); and

(which we refer to as the Share Cap ), subject to certain adjustments as described herein; in each case, on the terms and subject to the conditions described in this prospectus supplement, including provisions for the receipt, under specified circumstances, of alternative consideration as described in this prospectus supplement. See Description of Series C Preferred Stock Conversion Rights of Series C Preferred Stockholders beginning on page S-36 of this prospectus supplement.

The Series C Preferred Stock has no maturity date and is not subject to any sinking fund or mandatory redemption. Accordingly, the Series C Preferred Stock will remain outstanding indefinitely unless redeemed by us or converted into our common stock in connection with a Change of Control by the holders of the Series C Preferred Stock.

Holders of the Series C Preferred Stock will generally not have voting rights, but will have limited voting rights if we fail to pay dividends for six or more quarters (whether or not consecutive) and under certain other circumstances.

The Series C Preferred Stock is subject to certain restrictions on ownership designed to preserve our qualification as a real estate investment trust (which we refer to as a REIT ) under the United States Internal Revenue Code of 1986 (which we refer to as the Code ). See Description of Series C Preferred Stock Restrictions on Ownership on page S-40 of this prospectus supplement and Description of Our Capital Stock Restrictions on Transfer beginning on page 33 of the accompanying prospectus.

No current market exists for the Series C Preferred Stock. We intend to apply to list the Series C Preferred Stock on the New York Stock Exchange (which we refer to as the NYSE ) under the symbol ANHPrC. If the application is approved, trading of the Series C Preferred Stock on the NYSE is expected to begin within 30 days after the date of initial issuance of the Series C Preferred Stock.

Investing in the Series C Preferred Stock involves risks. See **Risk Factors** beginning on page S-12 of this prospectus supplement, beginning on page 9 of the accompanying prospectus, and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, which is incorporated by reference in the accompanying prospectus.

	<b>Per Share</b>	<b>Total</b>
Price to public	\$	\$
Underwriting discounts and commissions	\$	\$
Proceeds, before expenses, to us	\$	\$

We have granted to the underwriters the right to purchase within 30 days from the date of this prospectus supplement up to an additional \_\_\_\_\_ shares of the Series C Preferred Stock at the public offering price per share, less underwriting discounts and commissions, to cover over-allotments.

The underwriters expect to deliver the shares of Series C Preferred Stock on or about \_\_\_\_\_, 2015 through the book-entry facilities of The Depository Trust Company.

Neither the U.S. Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

***Joint Book-Running Managers***

**MLV & Co.**

**JMP Securities**

***Co-Managers***

**Ladenburg Thalmann**

**Maxim Group LLC**

The date of this prospectus supplement is January \_\_\_\_\_, 2015.

**Table of Contents****TABLE OF CONTENTS**

	<b>Page</b>
<b>Prospectus Supplement</b>	
<u>Forward-Looking Statements</u>	S-1
<u>Prospectus Supplement Summary</u>	S-3
<u>Risk Factors</u>	S-12
<u>Use of Proceeds</u>	S-20
<u>Capitalization</u>	S-21
<u>Distributions</u>	S-22
<u>Ratio of Earnings to Combined Fixed Charges and Preferred Dividends</u>	S-23
<u>Our Company</u>	S-24
<u>Description of Series C Preferred Stock</u>	S-30
<u>Additional Federal Income Tax Considerations</u>	S-41
<u>Underwriting</u>	S-44
<u>Legal Matters</u>	S-46
<u>Experts</u>	S-46
<b>Prospectus</b>	
<u>About This Prospectus</u>	1
<u>Forward-Looking Statements</u>	2
<u>Our Company</u>	3
<u>Risk Factors</u>	9
<u>Use of Proceeds</u>	31
<u>Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends</u>	31
<u>Description of our Capital Stock</u>	31
<u>Description of Warrants</u>	34
<u>Selected Provisions of Maryland Law, Our Charter and Bylaws</u>	35
<u>Certain Federal Income Tax Considerations</u>	38
<u>Plan of Distribution</u>	57
<u>Experts</u>	59
<u>Legal Matters</u>	59
<u>Information Incorporated by Reference</u>	59
<u>Where You Can Find More Information</u>	60

**You should rely only on the information contained in or incorporated by reference in this prospectus supplement and the accompanying prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different or inconsistent information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. The information contained in this prospectus supplement and the accompanying prospectus is accurate only as of the date such information is presented, and the information contained in any document incorporated or deemed to be incorporated by reference is accurate only as of the date of such document. Our business, financial condition, results of**

**operations and prospects may have changed since such dates.**

**The information in this prospectus supplement updates information in the accompanying prospectus and, to the extent it is inconsistent with the information in the accompanying prospectus, replaces such information.**

**Table of Contents**

**FORWARD-LOOKING STATEMENTS**

This prospectus supplement and the accompanying prospectus contain or incorporate by reference certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended, and, as such, may involve known and unknown risks, uncertainties and assumptions. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. You can generally identify forward-looking statements as statements containing the words may, will, believe, expect, anticipate, intend, estimate, assume or other similar expressions. You should be cautious of our forward-looking statements because the matters they describe are subject to assumptions, known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors, some of which are listed under the caption **Risk Factors** in this prospectus supplement beginning on page S-12, in the accompanying prospectus beginning on page 9, or in the reports that we file from time to time with the U.S. Securities and Exchange Commission (which we refer to as the **SEC**), such as our quarterly and annual reports.

Statements regarding the following subjects are forward-looking by their nature:

our business and investment strategy;

market trends and risks;

assumptions regarding credit risk;

changes in interest rates and the market value of our mortgage-backed securities (which we refer to as **MBS**);

risks associated with investing in mortgage assets;

changes in the yield curve;

the availability of MBS for purchase;

changes in the prepayment rates on the mortgage loans securing our MBS;

our ability to borrow to finance our assets and, if available, the terms of any financing; implementation of or changes in government regulations or programs affecting our business;

changes in business conditions and the general economy, including the consequences of actions by the U.S. government and other foreign governments to address the global financial crisis;

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

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

our ability to manage our growth.

These forward-looking statements are subject to various risks and uncertainties, including those relating to:

increases in the prepayment rates on the mortgage loans securing our mortgage-backed securities;

changes in the yield curve;

the availability of financing at reasonable levels and terms to support investing on a leveraged basis;

the availability of mortgage-backed securities for purchase;

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

risks associated with investing in mortgage-related assets, including changes in business conditions and the general economy, including the consequences of actions by the U.S. government and other foreign governments to address the global financial crisis;

**Table of Contents**

changes in government regulations affecting our business;

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

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

the impact of differing levels of leverage employed;

the liquidity of secondary markets and credit markets; and

management's ability to manage our growth and planned expansion.

Other risks, uncertainties and factors, including those discussed under "Risk Factors" in this prospectus supplement beginning on page S-12, in the accompanying prospectus beginning on page 9, or in the reports that we file from time to time with the SEC, such as our quarterly and annual reports, could cause our actual results to differ materially and in an adverse manner from those projected in any forward-looking statements we make. We are not obligated to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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 us. Except as required by law, we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.



**Table of Contents**

**PROSPECTUS SUPPLEMENT SUMMARY**

*The following summary highlights information contained elsewhere or incorporated by reference in this prospectus supplement and the accompanying prospectus. It may not contain all of the information that is important to you. Before making a decision to invest in the Series C Preferred Stock, you should read carefully this entire prospectus supplement and the accompanying prospectus, including the risks set forth under the caption "Risk Factors" in this prospectus supplement, the accompanying prospectus, and our Annual Report on Form 10-K for the fiscal year ended December 31, 2013. This summary is qualified in its entirety by the more detailed information and financial statements, including the notes thereto, appearing elsewhere or incorporated by reference in this prospectus supplement and the accompanying prospectus. Unless otherwise indicated, the information in this prospectus supplement assumes that the underwriters' over-allotment option is not exercised.*

**The Company**

We were incorporated in Maryland on October 20, 1997 and we commenced operations on March 17, 1998. We are in the business of investing primarily in U.S. agency mortgage-backed securities (which we refer to as "Agency MBS"), which are securities representing obligations guaranteed by the U.S. government, such as Ginnie Mae, or federally sponsored enterprises, such as Fannie Mae or Freddie Mac. Our principal business objective is to generate net income for distribution to our stockholders based upon the spread between the interest income on our mortgage assets and the costs of borrowing to finance our acquisition of those assets.

We have elected to be taxed as a REIT under the Code. As long as we retain our REIT status, we generally will not be subject to federal or state taxes on our income to the extent that we distribute our taxable net income to our stockholders, and we routinely distribute to our stockholders substantially all of the taxable income generated from our operations. In order to qualify as a REIT, we must meet various ongoing requirements under the tax law, including requirements relating to the composition of our assets, the nature of our gross income, minimum distribution requirements, and requirements relating to the ownership of our stock. We believe that we have met all of these requirements, and that we will continue to qualify as a REIT.

In February of 2014, we incorporated our wholly-owned Qualified REIT Subsidiary (which we refer to as a "QRS"), Anworth Properties, Inc., which commenced operations in March 2014. We incorporated Anworth Property Services, Inc., which we intend will elect to be treated as a Taxable REIT Subsidiary (which we refer to as a "TRS") that is wholly-owned by the Company and currently not in operation. Our QRS will provide the entity through which we may own REIT-qualified real estate assets such as: (1) other types of mortgage assets, from which we would receive interest income; and (2) real estate assets, from which we would receive rental income and potential price appreciation. Our TRS will provide the entity through which we may participate in various activities that might otherwise have adverse tax consequences if conducted directly by a REIT or a QRS. Unlike a REIT, a TRS pays standard corporate taxes on its income earned from these activities in the mortgage and real estate markets. These other activities include almost everything other than receiving rent on properties owned and collecting interest on real estate mortgages owned. Examples of these other activities include: the securitization of mortgage loans; mortgage origination; leasing and managing rental properties; and owning properties acquired through the foreclosure process.

Pursuant to a Management Agreement (which we refer to as the "Management Agreement"), between us and Anworth Management, LLC (which we refer to as the "Manager"), effective as of December 31, 2011, our day-to-day operations are being conducted by the Manager. The Manager is supervised and directed by our board of directors and is responsible for (i) the selection, purchase and sale of our investment portfolio; (ii) our financing and hedging activities; and (iii) providing us with management services. The Manager will also perform such other services and activities relating to our assets and operations as may be appropriate. In exchange for these services, the Manager

receives a management fee paid monthly in arrears in an amount equal to one-twelfth of 1.20% of our Equity (as defined in the Management Agreement). The term of the Management

S-3

## **Table of Contents**

Agreement expired on December 31, 2013 and automatically renews for successive one-year renewal terms unless either party elects not to renew. If we terminate the Management Agreement, or elect not to renew without cause, then we will be required to pay a termination fee equal to three times the average annual management fee earned during the prior 24-month period. At September 30, 2014, if this hypothetical event had occurred, the termination fee would have been approximately \$34.8 million.

## **General Information**

Our principal executive offices are located at 1299 Ocean Avenue, Second Floor, Santa Monica, California, 90401. Our telephone number is (310) 255-4493 and our fax number is (310) 434-0070. Our website is [www.anworth.com](http://www.anworth.com). The contents of our website are not a part of this prospectus supplement or the accompanying prospectus. Our shares of common stock are traded on the NYSE under the symbol ANH. Our shares of Series A Preferred Stock and Series B Preferred Stock are listed on the NYSE under the symbols ANHPrA and ANHPrB, respectively.

## **Recent Developments**

On October 17, 2014, we declared a dividend of \$0.539063 per share on our Series A Preferred Stock for the fourth quarter of 2014. The Series A Preferred Stock dividend is payable on January 15, 2015 to holders of record of our Series A Preferred Stock as of the close of business on December 31, 2014. The dividend reflects the period from October 1, 2014 through December 31, 2014.

On October 17, 2014, we also declared a dividend of \$0.390625 per share on our Series B Preferred Stock for the fourth quarter of 2014. The Series B Preferred Stock dividend is payable on January 15, 2015 to holders of record of our Series B Preferred Stock as of the close of business on December 31, 2014. The dividend reflects the period from October 1, 2014 through December 31, 2014.

On December 18, 2014, we declared a quarterly common stock dividend of \$0.14 per share for the fourth quarter of 2014. The common stock dividend is payable on January 29, 2015 to holders of record of our common stock as of the close of business on December 30, 2014. When we pay a cash dividend during any quarterly fiscal period to the holders of our common stock in an amount that results in an annualized common stock dividend yield greater than 6.25% (the dividend yield on our Series B Preferred Stock), the conversion rate on our Series B Preferred Stock is adjusted based on a formula specified in the Articles Supplementary Establishing and Fixing the Rights and Preferences of the Series B Preferred Stock. As a result of this quarterly common stock dividend, on December 30, 2014, we announced that, in accordance with the terms of our Series B Preferred Stock, the conversion rate of our Series B Preferred Stock will increase from 4.1519 shares of our common stock to 4.2029 shares of our common stock effective December 31, 2014.

**Table of Contents****Selected Financial Data**

The selected statement of income and balance sheet data as of December 31, 2012 and 2013 and for the three years in the period ended December 31, 2013 are derived from our audited financial statements incorporated by reference in this prospectus supplement and the accompanying prospectus. The selected statement of income and balance sheet data as of December 31, 2009, 2010 and 2011 and for the years ended December 31, 2009, 2010 and 2011 are derived from audited financial statements not included in this prospectus supplement or the accompanying prospectus. The selected financial data for the nine months ended September 30, 2013 and 2014 are derived from our unaudited financial statements for these periods. You should read these selected financial data together with Management's Discussion and Analysis of Financial Condition and Results of Operations and our audited and unaudited financial statements and notes thereto that are included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 and our Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2014, which are incorporated by reference into this prospectus supplement and the accompanying prospectus.

	2009	Year Ended December 31, 201020112012			2013	Nine Months Ended September 30, 20132014	
		(audited)				(unaudited)	
(amounts in thousands, except per share data and days)							
Consolidated Statements of Income Data:							
Days in period	365	365	365	366	365	273	273
Interest income net of amortization of premium and discount	\$ 262,029	\$ 219,803	\$ 224,180	\$ 195,853	\$ 174,784	\$ 131,368	\$ 123,151
Interest expense	(115,707)	(95,830)	(89,265)	(86,073)	(92,970)	(64,394)	(73,185)
Net interest income	146,322	123,973	134,915	109,780	81,814	66,974	49,966
Net gain (loss) on sales of assets	0	0	0	4,434	9,237	9,237	(4,022)
Net gain on derivative instruments	107	0	0	0	0	0	10,843
Other income	0	270	2,225	1,426	397	333	108
Expenses	(16,195)	(13,744)	(14,264)	(15,422)	(15,728)	(11,914)	(13,987)
Net income	\$ 130,234	\$ 110,499	\$ 122,876	\$ 100,218	\$ 75,720	\$ 64,630	\$ 42,908
Dividend on preferred stock	\$ (5,906)	\$ (5,764)	\$ (5,885)	\$ (5,773)	\$ (5,736)	\$ (4,307)	\$ (4,287)
Net income available to common stockholders	\$ 124,328	\$ 104,735	\$ 116,991	\$ 94,445	\$ 69,984	\$ 60,323	\$ 38,621
Basic earnings per share available to common stockholders	\$ 1.18	\$ 0.89	\$ 0.91	\$ 0.68	\$ 0.49	\$ 0.42	\$ 0.30

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Average number of shares outstanding	105,413	118,164	128,601	138,382	142,455	143,176	128,174
Diluted earnings per share available to common stockholders	\$ 1.16	\$ 0.87	\$ 0.90	\$ 0.67	\$ 0.49	\$ 0.42	\$ 0.30
Average number of diluted shares outstanding	108,905	121,919	132,759	142,485	146,400	147,118	132,254
Series A Preferred stock dividends declared per share	\$ 2.1563	\$ 2.1563	\$ 2.1563	\$ 2.1563	\$ 2.1563	\$ 1.6172	\$ 1.6172
Series B Preferred stock dividends declared per share	\$ 1.5625	\$ 1.5625	\$ 1.5625	\$ 1.5625	\$ 1.5625	\$ 1.1719	\$ 1.1719
Common stock dividends declared per common share	\$ 1.18	\$ 0.97	\$ 0.94	\$ 0.69	\$ 0.50	\$ 0.42	\$ 0.42

S-5

**Table of Contents**

	Year Ended December 31,					Nine Months Ended	
	2009	2010	2011	2012	2013	2013	2014
			(audited)			(unaudited)	
	(amounts in thousands, except per share data and days)						
Consolidated Balance Sheets Data:							
Agency mortgage-backed securities, net	\$ 6,490,543	\$ 7,739,052	\$ 8,763,479	\$ 9,244,693	\$ 8,556,446	\$ 8,766,250	\$ 7,411,252
Residential real estate	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 12,362
Derivative instruments	\$ 2,059	\$ 8,828	\$ 0	\$ 111	\$ 22,551	\$ 13,003	\$ 662,095
Total assets	\$ 6,526,648	\$ 7,790,215	\$ 8,813,769	\$ 9,285,105	\$ 8,619,491	\$ 8,828,786	\$ 8,117,152
Repurchase agreements	\$ 5,359,000	\$ 6,375,000	\$ 7,595,000	\$ 8,020,000	\$ 7,580,000	\$ 7,575,000	\$ 6,550,000
Derivative instruments	\$ 82,811	\$ 70,557	\$ 96,808	\$ 96,144	\$ 55,914	\$ 81,347	\$ 671,288
Junior subordinated notes	\$ 37,380	\$ 37,380	\$ 37,380	\$ 37,380	\$ 37,380	\$ 37,380	\$ 37,380
Total liabilities	\$ 5,597,337	\$ 6,896,304	\$ 7,804,243	\$ 8,197,388	\$ 7,717,305	\$ 7,921,105	\$ 7,292,829
Series B Preferred Stock	\$ 25,803	\$ 25,630	\$ 27,239	\$ 25,222	\$ 23,924	\$ 23,924	\$ 23,924
Stockholders equity	\$ 903,508	\$ 868,281	\$ 982,287	\$ 1,062,495	\$ 878,262	\$ 883,757	\$ 800,399
Number of common shares outstanding	115,563	120,901	134,115	142,013	138,717	141,603	118,554
Book value per common share	\$ 7.40	\$ 6.78	\$ 6.96	\$ 7.14	\$ 5.98	\$ 5.89	\$ 6.34

**Table of Contents**

**The Offering**

Issuer	Anworth Mortgage Asset Corporation
Securities Offered	shares of 7.625% Series C Cumulative Redeemable Preferred Stock (plus up to shares of Series C Preferred Stock issuable upon exercise of the underwriters' over-allotment option).
Ranking	The Series C Preferred Stock ranks senior to our common stock and on parity with our Series A Preferred Stock and Series B Preferred Stock with respect to the payments of distributions and amounts, upon liquidation, dissolution or winding up.
Dividends	You will be entitled to receive cumulative cash dividends on the Series C Preferred Stock at a rate of 7.625% per year of the \$25.00 liquidation preference (equivalent to \$1.90625 per share per year). Dividends on the Series C Preferred Stock are payable quarterly in arrears on the 15th day of January, April, July and October of each year, or if such day is not a business day, the next succeeding business day, beginning on April 15, 2015. Dividends paid to investors on the Series C Preferred Stock issued in this offering will be cumulative from January , 2015.
Liquidation Preference	If we liquidate, dissolve or wind up, you will have the right to receive \$25.00 per share of Series C Preferred Stock, plus accrued and unpaid dividends (whether or not declared) to the date of payment, before any payments are made to our common stockholders or to holders of any other of our equity securities that we may issue ranking junior to the Series C Preferred Stock as to liquidation rights. Your rights to receive the liquidation preference will be subject to the proportionate rights of each other series or class of our equity securities ranking on parity with the Series C Preferred Stock that we may issue, including our Series A Preferred Stock and Series B Preferred Stock.
Restrictions on Ownership and Transfer	Subject to certain exceptions, no person may own, directly or indirectly, more than 9.8% (in value or number of shares, whichever is more restrictive) of the outstanding shares of the Series C Preferred Stock, and no person may own, directly or indirectly, more than 9.8% in value of the aggregate of our outstanding shares of capital stock. Our board of directors, in its discretion on a limited basis, can grant waivers to increase this ownership limitation, and has done so in the past.

If any transfer of shares of the Series C Preferred Stock or other capital stock occurs (including the acquisition of common stock upon a conversion of the Series C Preferred Stock) which, if effective, would result in any person owning, directly or indirectly, shares of our capital stock in violation of the ownership limits set forth above, then that number of shares which would cause the violation will be automatically transferred to a trust for the benefit of a charitable

S-7



## Table of Contents

beneficiary, or if the transfer to the trust would not be effective for any reason to prevent the violation of the ownership limit, then the transfer of that number of shares which would cause the violation will be void *ab initio* and the intended transferee will not acquire any rights in such shares of capital stock.

See Description of Series C Preferred Stock Restrictions on Ownership in this prospectus supplement and Description of Our Capital Stock Restrictions on Transfer in the accompanying prospectus.

### Voting Rights

You will generally not have voting rights. If, however, dividends on any outstanding Series C Preferred Stock are in arrears for six or more quarterly periods (whether or not consecutive), the number of directors then constituting our board of directors will be increased by two, and holders of the Series C Preferred Stock (which we refer to as Series C Preferred Stockholders), voting as a class with the stockholders of any other classes or series of our equity securities ranking on parity with the Series C Preferred Stock which are entitled to similar voting rights, including our Series A Preferred Stock and Series B Preferred Stock, will be entitled to elect the two additional members of our board of directors to serve until all unpaid cumulative dividends have been paid or declared and set apart for payment. In addition, certain material and adverse changes to the terms of the Series C Preferred Stock cannot be made and certain other actions may not be taken without the affirmative vote of at least two-thirds of the outstanding shares of the Series C Preferred Stock and classes and series of parity stock, including our Series A Preferred Stock and Series B Preferred Stock, voting together as a single class.

### Maturity

The Series C Preferred Stock will have no maturity date and will not be subject to any sinking fund or mandatory redemption. Accordingly, the Series C Preferred Stock will remain outstanding indefinitely unless we redeem it pursuant to the circumstances described under Optional Redemption or Special Optional Redemption below, or, if we do not redeem it, you elect to convert it following a Change of Control. See Description of Series C Preferred Stock Redemption and Conversion Rights of Series C Preferred Stockholders.

### Optional Redemption

Except as described below under Special Optional Redemption, the Series C Preferred Stock is not redeemable prior to January 1, 2020. On or after January 1, 2020, we may, at our option, redeem the Series C Preferred Stock, in whole or in part, at any time or from time to time, for cash at a redemption price of \$25.00 per share, plus any accrued and unpaid dividends to, but not including, the date fixed for redemption. See Description of Series C Preferred Stock Redemption Optional

Redemption.

Special Optional Redemption

Upon the occurrence of a Change of Control, we may, at our option, redeem the Series C Preferred Stock, in whole or in part, within 120

S-8

**Table of Contents**

days after the first date on which such Change of Control occurred, for cash at a redemption price of \$25.00 per share, plus any accrued and unpaid dividends (whether or not declared) to, but not including, the date fixed for redemption (unless the redemption date is after a Dividend Record Date (as defined herein) and prior to the corresponding Dividend Payment Date (as defined herein), in which case no additional amount for such accrued and unpaid dividends will be included in the redemption price).

If, prior to the Change of Control Conversion Date (as defined in Description of Series C Preferred Stock Conversion Rights of Series C Preferred Stockholders Conversion Procedures ), we have provided notice of our election to redeem some or all of the shares of Series C Preferred Stock (whether pursuant to our optional redemption right described above or this special optional redemption right), Series C Preferred Stockholders will not have the conversion right described below under Conversion Rights of Series C Preferred Stockholders with respect to the shares of Series C Preferred Stock called for redemption.

A Change of Control is deemed to occur when, after the original issuance of the Series C Preferred Stock, the following have occurred and are continuing:

1. (a) any person or group (as such terms are used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (which we refer to as the Exchange Act )) acquires the beneficial ownership, directly or indirectly, through a purchase, merger or other acquisition transaction or series of transactions, of 50% or more of the total voting power of our total outstanding voting stock other than an acquisition by us or any of our subsidiaries;
- (b) we consolidate with, or merge with or into, another person or convey, transfer, lease or otherwise dispose of all or substantially all of our assets to any person, or any person consolidates with or merges with or into us, other than: (i) any transaction (x) that does not result in any reclassification, exchange, or cancellation of outstanding shares of our capital stock, and (y) pursuant to which our capital stockholders immediately prior to the transaction have the entitlement to exercise, directly or indirectly, 50% or more of the total voting power of all shares of our capital stock entitled to vote generally in the election of directors of the continuing or surviving person immediately after the transaction; or (ii) any

merger solely for the purpose of changing our jurisdiction of formation and resulting in a reclassification, conversion or exchange of outstanding shares of common stock solely into shares of common stock of the surviving entity; or

- (c) we approve a plan of liquidation or dissolution; and

S-9

**Table of Contents**

2. following the closing of any transaction referred to in (1) above, neither we nor the acquiring or surviving entity has a class of common securities listed for trading on a United States national securities exchange (including the Nasdaq Stock Market).

See Description of Series C Preferred Stock Redemption Special Optional Redemption.

**Conversion Rights of Series C Preferred Stockholders**

Upon the occurrence of a Change of Control, you will have the right, subject to our election to redeem the Series C Preferred Stock, in whole or in part, prior to the Change of Control Conversion Date (as described above under Optional Redemption and Special Optional Redemption ), to convert some or all of the shares of Series C Preferred Stock held by you on the Change of Control Conversion Date into a number of shares of our common stock per share of Series C Preferred Stock equal to the lesser of:

- (i) the quotient obtained by dividing (A) the sum of the \$25.00 liquidation preference per share of Series C Preferred Stock plus the amount of any accrued and unpaid dividends to, but not including, the Change of Control Conversion Date (unless the Change of Control Conversion Date is after a Dividend Record Date and prior to the corresponding Dividend Payment Date for the Series C Preferred Stock, in which case no additional amount for such accrued and unpaid dividends will be included in this sum) by (B) the Common Stock Price (as defined herein); and
- (ii) (which we refer to as the Share Cap ), subject to adjustments to the Share Cap for any splits, subdivisions or combinations of our common stock;

in each case, on the terms and subject to the conditions described in this prospectus supplement, including provisions for the receipt, under specified circumstances, of alternative consideration as described in this prospectus supplement.

Except as described above, the Series C Preferred Stock is not convertible. See Description of the Series C Preferred Stock Conversion Rights of Series C Preferred Stockholders.

During any period in which we are not subject to Section 13 or 15(d) of the Exchange Act and any shares of Series C Preferred Stock are outstanding, we will use our best efforts to (i) transmit by mail (or other permissible means under the Exchange Act) to all Series C Preferred Stockholders, as their names and addresses appear on our record books and without cost to such holders, copies of the annual reports on Form 10-K and quarterly reports on Form 10-Q that we would have been required to file with the SEC pursuant to Section 13 or 15(d) of the Exchange Act if we were subject thereto (other than any exhibits that would have been required), and (ii) promptly, upon request, supply copies of such reports to any current or prospective Series C Preferred Stockholder, subject to certain exceptions

S-10

**Table of Contents**

described in this prospectus supplement. We will use our best efforts to mail (or otherwise provide) the information to the Series C Preferred Stockholders within 15 days after the respective dates by which a periodic report on Form 10-K or Form 10-Q, as the case may be, in respect of such information would have been required to be filed with the SEC, if we were subject to Section 13 or 15(d) of the Exchange Act, in each case, based on the dates on which we would be required to file such periodic reports if we were a non-accelerated filer within the meaning of the Exchange Act.

**Transfer Agent**

The transfer agent, registrar and dividend disbursing agent for the Series C Preferred Stock will be American Stock Transfer & Trust Company.

**Listing**

We intend to apply to list the Series C Preferred Stock on the NYSE under the symbol ANHPrC. If the application is approved, trading of the Series C Preferred Stock on the NYSE is expected to begin within 30 days after the date of initial issuance of the Series C Preferred Stock.

**Form and Book-Entry System**

The Series C Preferred Stock will only be issued in the form of global securities held in book-entry form. The Depository Trust Company (which we refer to as DTC) or its nominee will be the sole registered holder of the Series C Preferred Stock. Owners of beneficial interests in the Series C Preferred Stock represented by the global securities will hold their interests pursuant to the procedures and practices of DTC. As a result, beneficial interests in any such securities will be shown on, and transfers will be affected only through, records maintained by DTC and its direct and indirect participants and any such interest may not be exchanged for certificated securities, except in limited circumstances.

**Use of Proceeds**

We will use the net proceeds from this offering to acquire mortgage-related assets consistent with our investment policy and to potentially redeem shares of our Series A Preferred Stock.

**Risk Factors**

Investing in the Series C Preferred Stock involves risks. Please see Risk Factors beginning on page S-12 of this prospectus supplement, beginning on page 9 of the accompanying prospectus, and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, which is incorporated by reference in the accompanying prospectus, for a discussion of risks you should carefully consider before deciding to invest in the Series C Preferred Stock.





**Table of Contents**

**RISK FACTORS**

*An investment in the Series C Preferred Stock involves various risks, including those described below, the risks set forth under the caption Risk Factors included in our Annual Report on Form 10-K for the fiscal year on December 31, 2013 and in the accompanying prospectus beginning on page 9. You should carefully consider such risk factors, together with all of the information contained in or incorporated by reference in this prospectus supplement and the accompanying prospectus, in determining whether to purchase the Series C Preferred Stock. If any of the risks described below, in our Annual Report on Form 10-K, or in the accompanying prospectus actually occur, our business, operating results, prospects and financial condition could be harmed. This could cause the market price of the Series C Preferred Stock to decline and could cause you to lose all or part of your investment.*

**Risks Related to this Offering and Ownership of the Series C Preferred Stock**

***An active trading market for the Series C Preferred Stock may not develop.***

The Series C Preferred Stock is a new issue of securities for which there is currently no public market. We intend to apply to list the Series C Preferred Stock on the NYSE under the symbol ANHPrC. We do not know whether an active trading market will develop for the Series C Preferred Stock. The liquidity of any market for the Series C Preferred Stock will depend upon the number of Series C Preferred Stockholders, our results of operations and financial condition, the market for similar securities, the interest of securities dealers in making a market in the Series C Preferred Stock and other factors. To the extent that an active trading market does not develop, the liquidity and trading prices for the Series C Preferred Stock may be harmed.

The trading price of the Series C Preferred Stock may depend on many factors, including:

prevailing interest rates;

the market price of our common stock;

the market for similar securities;

additional issuances by us of common shares;

additional issuances by us of other series or classes of preferred shares;

general economic conditions; and

our financial condition, performance and prospects.

Each of these factors, among others, may cause the trading price of the Series C Preferred Stock to fall below the offering price, which could have a material adverse effect on your investment in the Series C Preferred Stock.

***If you hold Series C Preferred Stock you will not be entitled to any rights with respect to our common stock, but you will be subject to all changes made with respect to our common stock.***

If you hold Series C Preferred Stock, you will not be entitled to any rights with respect to our common stock (including, without limitation, voting rights and rights to receive any dividends or other distributions on our common stock), but you will be subject to all changes affecting the common stock. You will have rights with respect to our common stock only if and when we deliver common stock to you upon conversion of your Series C Preferred Stock. For example, in the event that an amendment is proposed to our articles of incorporation or bylaws requiring stockholder approval and the record date for determining the stockholders of record entitled to vote on the amendment occurs prior to the delivery of common stock to you following a conversion, you will not be entitled to vote on the amendment, although you will nevertheless be subject to any changes in the powers, preferences or special rights of our common stock.

S-12

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**Table of Contents**

***Shares of the Series C Preferred Stock have not been rated and our future offerings of debt or preferred equity securities may adversely affect the value of the Series C Preferred Stock.***

The shares of the Series C Preferred Stock have not been rated by any nationally recognized statistical rating organization. Furthermore, our charter provides that we may issue up to 20,000,000 shares of preferred stock in one or more series. In addition to our outstanding Series A Preferred Stock and Series B Preferred Stock, we currently have an agreement with Cantor Fitzgerald & Co., pursuant to which we may issue up to an additional 1.0 million shares of our Series A Preferred Stock, of which 1,919,378 shares have been issued, and up to an additional 1.0 million shares of our Series B Preferred Stock, of which 1,009,640 shares have been issued. The issuance of additional preferred stock on par with or senior to the Series C Preferred Stock could have the effect of diluting the amounts we may have available for the payment of dividends and the distribution of assets upon liquidation, dissolution or winding up. The Series C Preferred Stock will be subordinated to all our existing and future debt. The Series C Preferred Stock does not contain any provisions affording the Series C Preferred Stockholders protection in the event of a highly leveraged or other transaction, including a merger or the sale, lease or conveyance of all or substantially all our assets or business, that might harm the Series C Preferred Stockholders.

***Our charter contains limits on ownership and transfer of the Series C Preferred Stock and common stock, which could have adverse consequences to you.***

To assist us in maintaining our qualification as a REIT for U.S. federal income tax purposes, our charter provides that, with certain exceptions, no person or entity may own, directly or by the attribution provisions of the U.S. federal tax laws, more than 9.8% (in value or number of shares, whichever is more restrictive) of the outstanding shares of our common stock, or, with respect to any class or series of preferred stock, 9.8% (in value or number of shares, whichever is more restrictive) of the outstanding shares of such class or series of preferred stock, including the Series C Preferred Stock, and no person or entity may own, directly or by the attribution provisions of the U.S. federal tax laws, more than 9.8% of the value of our outstanding shares of capital stock. Our board of directors, in its sole and absolute discretion, may waive or modify the ownership limit with respect to one or more persons or entities who would not be treated as individuals for purposes of the U.S. federal tax laws if it is satisfied, based upon information required to be provided by the party seeking the waiver or upon an opinion of counsel satisfactory to the board of directors, that ownership in excess of this limit will not otherwise jeopardize our status as a REIT for U.S. federal income tax purposes.

If any transfer of shares of the Series C Preferred Stock or other capital stock occurs (including the acquisition of common stock upon a conversion of the Series C Preferred Stock) which, if effective, would result in any person owning, directly or indirectly, shares of our capital stock in violation of the ownership limits set forth above, then that number of shares which would cause the violation will be automatically transferred to a trust for the benefit of a charitable beneficiary, or if the transfer to the trust would not be effective for any reason to prevent the violation of the ownership limit, then the transfer of that number of shares which would cause the violation will be void *ab initio* and the intended transferee will not acquire any rights in such shares of capital stock.

The ownership limit and transfer restrictions may have the effect of delaying, deferring or preventing a change of control and, therefore, could adversely affect our stockholders' ability to realize a premium over the then prevailing market price for our common stock in connection with a change of control. The ownership limit and transfer restrictions would also preclude Series C Preferred Stockholders from increasing their position in the Series C Preferred Stock above the proscribed 9.8% limit without board approvals and may also constrain certain transferees from being able to purchase the Series C Preferred Stock.

***You should consider the United States federal income tax consequences of owning the Series C Preferred Stock.***

The principal U.S. federal income tax consequences of purchasing, owning and disposing of the Series C Preferred Stock and any common stock received upon their conversion are summarized under Additional

S-13

## **Table of Contents**

Federal Income Tax Considerations in this prospectus supplement and under Certain Federal Income Tax Considerations in the accompanying prospectus. If you are a foreign shareholder, such deemed dividend may subject you to U.S. federal withholding tax at a 30% rate or such lower rate as may be specified by an applicable treaty. See

Additional Federal Income Tax Considerations in this prospectus supplement and Certain Federal Income Tax Considerations in the accompanying prospectus.

***You may not be able to exercise conversion rights upon a Change of Control and, if exercisable, the Change of Control Conversion Right described in this prospectus supplement may not adequately compensate you.***

Upon the occurrence of a Change of Control, each Series C Preferred Stockholder will have the right (unless, prior to the Change of Control Conversion Date, we have provided notice of our election to redeem some or all of the shares of Series C Preferred Stock held by such holder as described under Description of Series C Preferred Stock Redemption Optional Redemption or Special Optional Redemption, in which case such holder will have the right only with respect to shares of Series C Preferred Stock that are not called for redemption, if any) to convert some or all of such holder's Series C Preferred Stock into our shares of common stock (or under specified circumstances, the Alternative Conversion Consideration, as defined herein). Notwithstanding that we generally may not redeem the Series C Preferred Stock prior to January , 2020, we have a special optional redemption right to redeem the Series C Preferred Stock in the event of a Change of Control, and the Series C Preferred Stockholders will not have the right to convert any shares that we have elected to redeem prior to the Change of Control Conversion Date. See Description of Series C Preferred Stock Redemption and Conversion Rights of Series C Preferred Stockholders.

If we do not elect to redeem the Series C Preferred Stock prior to the Change of Control Conversion Date, then upon an exercise of the conversion rights provided for in this prospectus supplement, the holders of Series C Preferred Stock will be limited to a maximum number of shares of our common stock (or, if applicable, the Alternative Conversion Consideration (as defined herein)) equal to , referred to as the Share Cap, multiplied by the number of shares of Series C Preferred Stock converted. If the Common Stock Price is less than \$ (which is approximately 50% of the per share closing sale price of our common stock reported on the NYSE on January , 2015), subject to adjustment in certain circumstances, the holders of the Series C Preferred Stock will receive a maximum of shares of our common stock per share of Series C Preferred Stock, which may result in a holder receiving shares of common stock (or Alternative Conversion Consideration, as applicable) with a value that is less than the liquidation preference of the Series C Preferred Stock plus any accrued and unpaid dividends.

## **Risks Related to Our Business**

***A decline in the fair market value of our Non-agency MBS could result in us recording impairments on these investments, which may have an adverse effect on our results of operations and financial condition.***

Non-agency MBS are accounted for under ASC 310-30, Loans and Debt Securities Acquired with Credit Deterioration (which we refer to as ASC 310-30 ). A debt security accounted for under ASC 310-30 is initially recorded at its purchase price (fair value). The amount of expected cash flows that exceed the initial investment represents accretable yield which is recognized as interest income on a level yield basis over the life of the security. The excess of total contractual cash flows over the cash flows expected at origination is considered to be non-accretable yield. We must periodically reassess the expected cash flows of loans accounted for under ASC 310-30, along with the cash flows received. A significant increase in expected cash flows must be accounted for as an increase in the rate of accretion over the remaining life of the security. Conversely, if expected cash flows decrease, an other-than-temporary impairment must be recognized as a charge to earnings. Adjustments to the fair value of Non-agency MBS, accounted for as available for sale securities, are recorded in accumulated other comprehensive income/(loss). The determination as to whether impairment and accretable yield exists is based on cash flow

projections related to the securities. As a result, the timing and amount of impairment and accretable yield constitutes a material estimate that is susceptible to significant change.

S-14

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**Table of Contents**

***Our investments in Non-Agency MBS involve credit risk, which could materially adversely affect our results of operations.***

Investments in MBS carry a risk that the borrower on the underlying mortgage may default on their obligations to make full and timely payments of principal and interest. Pursuant to our investment policy, we have the ability to acquire Non-Agency MBS and other investment assets of lower credit quality (less than investment grade). In general, Non-Agency MBS carry greater investment risk than Agency MBS because they are not guaranteed as to principal and/or interest by the U.S. Government, any federal agency or any federally chartered corporation. Unexpectedly high rates of default (i.e., in excess of the default rates forecasted) and/or higher than expected loss severities on the mortgages collateralizing our Non-Agency MBS may adversely affect the values of such assets. Accordingly, Non-Agency MBS and other investment assets of less-than-high credit quality could cause us to incur losses of income from, and/or losses in market value relating to, these assets if there are defaults of principal and/or interest on these assets.

***We may have significant credit risk, especially on Non-Agency MBS, in certain geographic areas and may be disproportionately affected by economic or housing downturns, natural disasters, terrorist events, adverse climate changes or other adverse events specific to those markets.***

A significant number of the mortgages collateralizing our MBS may be concentrated in certain geographic areas. Any event that adversely affects the economy or real estate market in these areas could have a disproportionately adverse effect on our Non-Agency MBS portfolio. In general, any material decline in the economy or significant difficulties in the real estate markets would be likely to cause a decline in the value of residential properties securing the mortgages in the relevant geographic area. This, in turn, would increase the risk of delinquency, default and foreclosure on real estate collateralizing our Non-Agency MBS in this area. This may then materially adversely affect our credit loss experience on our Non-Agency MBS in such area if unexpectedly high rates of default (i.e., in excess of the default rates forecasted) and/or higher than expected loss severities on the mortgages collateralizing such securities were to occur.

The occurrence of a natural disaster (such as an earthquake, tornado, hurricane, wildfires, or a flood) or a significant adverse climate change may cause a sudden decrease in the value of real estate and would likely reduce the value of the properties securing the mortgages collateralizing our Non-Agency MBS. Since certain natural disasters may not typically be covered by the standard hazard insurance policies maintained by borrowers, the borrowers may not be able to repair the properties or may stop paying their mortgages if the property is damaged. This would likely cause defaults and credit loss severities to increase on the pool of mortgages securing our Non-Agency MBS which may materially adversely affect our results of operations and financial condition.

***We may invest in Non-Agency MBS that are collateralized by loans of lower credit quality, such as Alt A loans, which, due to lower underwriting standards, are subject to increased risk of losses.***

We may invest in Non-Agency MBS backed by collateral pools containing mortgage loans that have been originated using underwriting standards that are less strict than those used in underwriting prime mortgage loans. These loans may experience delinquency, foreclosure, bankruptcy and loss rates that are higher than prime mortgage loans, which could cause the performance of Non-Agency MBS backed by such lower credit quality loans to be adversely affected, which could materially adversely impact our results of operations and financial condition.

***We may generate taxable income that differs from our GAAP income on Non-Agency MBS purchased at a discount to par value, which may result in significant timing differences in the recognition of income and losses.***

We may acquire Non-Agency MBS at prices that reflect significant market discounts on their unpaid principal balances. For financial statement reporting purposes, we would generally establish, on such securities, a portion of the discount as a non-accretable discount. This non-accretable discount is generally not accreted into

S-15



## **Table of Contents**

income for financial statement purposes. For tax purposes, however, we would not be permitted to establish a reserve for credit losses prior to their actual occurrence. Such differences between tax accounting and GAAP accounting can lead to significant timing differences in the recognition of income and losses. Taxable income on Non-Agency MBS purchased at a discount to par value may be higher than GAAP income in early periods (before losses are actually incurred) and lower than GAAP income in subsequent periods when the realized credit losses are incurred. As a REIT must distribute at least 90% of its annual taxable income (subject to certain adjustments) to our stockholders, such timing differences could affect the amount of the dividend distribution. However, dividends are declared and paid at the discretion of our board of directors and depend not only on REIT taxable income but also on our financial results, our overall financial condition, maintenance of our REIT qualification and such other factors as our board may deem relevant from time to time.

***Generally, Non-Agency MBS have greater price sensitivity than Agency MBS which could cause fluctuations in our book value. Such price fluctuations could cause repurchase agreement lenders to require greater amounts of collateral and higher margin requirements which could affect our results of operations and could cause us to sell our Non-Agency MBS at potentially distressed prices in periods of significant price fluctuation. It could also cause repurchase agreement lenders to withdraw their financing from such investments.***

Non-Agency MBS historically have been more price sensitive than Agency MBS which may limit the number of lenders willing to provide repurchase agreement financing for these securities. In periods of price volatility, we may be subject to higher margin requirements or may be required to pledge additional collateral which could affect our results of operations. Also, during periods of significant price fluctuation, lenders may cut back the amounts they are willing to finance on such investments or withdraw from lending on such securities. If we could not find replacement financing, this could cause us to sell our Non-Agency MBS at potentially distressed prices, which would adversely affect our results of operations and financial condition.

***The servicing of the mortgage loans that are the underlying collateral of our Non-Agency MBS is outside of our control and if this servicing is not successful in limiting future delinquencies, defaults and losses which could adversely affect our results of operations.***

Third party services provide for the servicing of the mortgage loans that are the underlying collateral of our Non-Agency MBS. These service providers control all aspects of loan collection, loss mitigation, default management and ultimate resolution of a defaulted loan. We have no contractual rights with respect to these service providers and their efforts may not be successful in limiting future delinquencies, defaults and losses which could adversely affect our results of operations.

## **Risks Related to Our Management**

***If we elect to not renew the Management Agreement without cause, we would be required to pay the Manager a substantial termination fee.***

It will be costly for us if we elect not to renew the Management Agreement without cause. With the consent of the majority of our independent directors, and with at least 180-days prior written notice before the end of the calendar year, we may elect to not renew the Management Agreement at the end of the calendar year. If we elect not to renew the Management Agreement without cause, we will be required to pay the Manager a termination fee equal to three times the average annual management fee earned by the Manager during the 24-month period immediately preceding the most recently completed quarter prior to the year-end termination of the Management Agreement.

After giving notice of our intent to not renew the Management Agreement without cause, we will continue to be required to pay the Manager the management fees stated in the Management Agreement until the end of the calendar year that the Management Agreement is not renewed. If such notice is given less than 180 days prior to

S-16

## **Table of Contents**

the end of the calendar year, the management fees will be paid until termination of the Management Agreement at the end of the following calendar year.

At September 30, 2014, if this termination event had occurred, the termination fee, based on the average annual management fee earned by the Manager during the 24-month period immediately preceding the most recently completed quarter prior to the effective date of termination, would be approximately \$34.8 million.

If we elect not to renew the Management Agreement without cause, we are also likely to become a party to employment litigation for wrongful termination and other issues under the laws of California.

***If we do not renew the Management Agreement for any reason, we would continue to be obligated to pay the sublease on our office premises in California.***

Our obligation to pay the sublease on our office premises does not end with termination of the Management Agreement. There can be no assurance that we can sublease our office space to another tenant at a rate which eliminates this obligation and is satisfactory to the sublessor and the building owner.

***Various corporate actions require the approval of the majority of all shareholders.***

There are corporate actions which can be implemented only if a majority of all shareholders approves at a convened meeting of shareholders. There can be no assurance that a majority of all shareholders will vote to approve any measure that only a majority of the voting shareholders had previously approved. Examples of actions which require the approval of a majority of all shareholders to pass are: an agreement of consolidation, merger, share exchange or transfer of assets; for dissolution of our company; or for a business combination between our company and an interested stockholder.

***During the two years after we elect without cause to not renew the Management Agreement, we will likely not be able to retain any of the Manager's employees to assist us in managing the Company on a full-time or interim basis.***

The Management Agreement provides that, without the consent of the Manager, the Company may not, for two years after termination of the Management Agreement, employ any employee of the Manager or any of its Affiliates or any Person who has been employed by the Manager or any of its Affiliates at any time within the two-year period immediately preceding the date on which the Person commences employment with the Company. This provision would make it unlikely that the Company would be able to immediately rely on the experience and knowledge of the employees of the former Manager to assist in any changes made by the board of directors, including assisting with the sale or liquidation of a substantial portion of the assets or a sale of the Company.

***In the event of a change of control, we will owe certain of the officers and employees of the Manager a payment as specified in their Change of Control and Arbitration Agreement between these officers/employees and the Company.***

In the event of a change of control of the Company, the Company would incur the costs of paying lump sum payments and other employee benefits to certain of the officers and employees of the Manager as specified in their Change of Control and Arbitration Agreement between these officers/employees and the Company.

## **Risks Related to Our Residential Properties Business**

***We are in a relatively new industry that has significant competition, and we have limited operating history in this sector, which makes this business difficult to evaluate and may affect our ability to operate this business in a profitable manner.***

Until very recently, the single-family residential rental business consisted primarily of private individual investors in local markets and was managed individually or by small local property managers. Within the past

S-17

## **Table of Contents**

few years, several institutional companies and REITs have entered this market and have attempted to acquire and operate single-family properties on a large-scale basis and to achieve attractive yields employing technology through a disciplined approach to acquisitions and leasing, marketing and management. Many of our competitors may be larger and have greater financial, technical, leasing, marketing and other resources than we do, which may affect our ability to acquire our target properties at attractive prices and attract quality tenants.

In addition, although we have several employees who have previously personally engaged in this business on a small scale, we have limited operating history as a company in this business and contract with various third-party professionals to assist us in acquiring and managing our properties and providing services to tenants. If these professionals do a poor job or don't perform to our expectations, it could affect the prices we pay to acquire properties, our relationships with our tenants, the operation of our properties, and our reputation in this business. These factors make this business difficult to evaluate, and may affect our ability to operate this business in a profitable manner.

***Many factors affect the single-family residential rental market and the profitability of this business will be affected both by our assumptions about this market and this market's conditions in our target areas.***

The success of our business model will depend upon many factors including, but not limited to: the availability of properties that meet our investment criteria and our ability to acquire such properties at favorable prices; real estate appreciation or depreciation in our target markets; the condition of our properties; our ability to contain renovation, maintenance, marketing and other operating costs for our properties; our ability to maintain high occupancy rates and target rent levels; general economic conditions in our target markets, such as changes in employment and household earnings and expenses; the effects of rent controls, stabilization laws and other laws or regulations regarding rental rates and tenant rights; and changes in, and changes in enforcement of, laws, regulations and government policies including health, safety, environmental, property, zoning and tax laws. We will have no control over many of these factors, which could adversely affect the profitability of this business. Our success will also depend, in part, on our assumptions about our target properties, our target renters, our renovation, maintenance and other operating costs, and our rental rates and occupancy levels and, if our assumptions prove to be inaccurate, this may adversely affect the profitability of this business.

***Initially, our portfolio of properties will be geographically concentrated and any adverse developments in local economic conditions, or the demand for single-family rental homes in these markets, or the occurrence of natural disasters may adversely affect the operating results of this business.***

Initially, our target markets will be in the east coast of Florida and we will be exposed to any adverse developments in local economic conditions or natural disasters in that area. Due to this geographic concentration, any such developments could affect our business to a greater extent than if our properties were less geographically concentrated.

***Poor resident selection and defaults by renters may adversely affect the financial performance of this business and harm our reputation.***

Our success depends, in large part, upon our ability to attract and retain qualified tenants. This will depend, in turn, upon our ability to screen applicants, identify good residents, avoid tenants who may default, and the willingness of our tenants to renew their leases. When properties are vacant, we are not earning rental income and incur maintenance costs as well as turnover costs associated with re-leasing the properties, such as marketing and leasing commissions. Additionally, if we have to evict tenants, we will incur legal costs and may have renovation costs if the tenants don't properly maintain the properties or cause damage to the properties. Our reputation in the communities where our properties are located may be harmed if our tenants are not good neighbors or do damage to our properties or to the

local communities.

S-18

**Table of Contents**

***Declining real estate values and impairment charges could adversely affect the earnings and financial condition of this business.***

Our success depends upon our ability to acquire rental properties at attractive values, such that we can earn a satisfactory return on our investment primarily through rental income and secondarily through increases in property values. If we overpay for properties, or if their values subsequently decline or fail to rise because of market factors, we may not achieve our financial objectives. Additionally, U.S. GAAP requires companies to take an impairment charge if there is a permanent decline in the value of a property based upon a review of various market factors. An impairment charge would reduce the net income in the period in which it was taken. Even if we concluded that an impairment charge was not needed, a decline in the value of a property may become manifest over time through reduced rental income from the property, which would affect the earnings and financial condition of this business.

**Risks Related to REIT Compliance and Other Tax Matters**

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

The REIT provisions of the Code may limit our ability to hedge certain risks relating to our investments and financing activities, in order to satisfy the gross income and asset requirements necessary for qualification as a REIT. As a result, we may in the future have to limit our use of advantageous hedging techniques or implement those hedges through a taxable REIT subsidiary. This could result in greater risks associated with changes in interest rates than we would otherwise want to incur. If we were to violate the REIT requirements, we might lose our qualification as a REIT or be required to pay a penalty tax in certain circumstances.

***Dividends payable by REITs do not qualify for the reduced tax rates.***

The maximum U.S. federal tax rate for qualified dividends paid by corporations to individuals, trusts and estates is currently 20%. Distributions paid by REITs, however, generally continue to be taxed at the normal ordinary income rate applicable to the individual recipient (subject to a maximum rate of 39.6%), rather than the preferential rate applicable to qualified dividends. The more favorable rates applicable to non-REIT corporate 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.

**Table of Contents**

**USE OF PROCEEDS**

We expect that the net proceeds to us from this offering of the Series C Preferred Stock, after deducting underwriting discounts and commissions and estimated offering expenses, will be approximately \$ ( \$ if the underwriters over-allotment option is exercised in full).

We are conducting this offering to increase our equity capital base which will allow us to grow our balance sheet through the deployment of equity and the use of leverage. We will use the net proceeds from this offering to acquire mortgage-related assets consistent with our investment policy and to potentially redeem shares of our Series A Preferred Stock. We then intend to increase our investment assets by borrowing against these mortgage-related assets and using the proceeds of such borrowings to acquire additional mortgage-related assets. Pending such investments, we will place the net proceeds in interest-bearing bank accounts or in readily marketable, interest-bearing securities.

S-20



Table of Contents**CAPITALIZATION**

The following table sets forth our actual capitalization as of September 30, 2014 and our capitalization as adjusted to give effect to the issuance of \_\_\_\_\_ shares of the Series C Preferred Stock in this offering, which assumes the underwriters do not exercise its over-allotment option.

The information set forth in the following table should be read in conjunction with, and is qualified in its entirety by, the financial statements and the notes thereto included in our Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, which is incorporated by reference into this prospectus supplement and the accompanying prospectus.

	<b>As of September 30, 2014</b>	
	<b>Actual</b>	<b>As Adjusted<sup>(1)</sup></b>
	<b>(in thousands)</b>	
7.625% Series C Cumulative Redeemable Preferred Stock, par value \$0.01 per share, liquidation preference \$25.00 per share; no shares issued and outstanding; _____ issued and outstanding, as adjusted	\$	\$
6.25% Series B Cumulative Convertible Preferred Stock, par value \$0.01 per share, liquidation preference \$25.00 per share; 1,010 shares issued and outstanding	\$ 23,924	\$
<b>Stockholders' Equity:</b>		
Preferred stock: 20,000 shares authorized		
8.625% Series A Cumulative Preferred Stock, par value \$0.01 per share, liquidation preference \$25.00 per share; 1,919 shares issued and outstanding	\$ 46,537	\$
Common stock, par value \$0.01 per share; 200,000 authorized; 118,554 shares issued and outstanding	1,186	
Additional paid-in capital	1,076,185	
Accumulated other comprehensive (loss) consisting of unrealized gains and losses	(46,469)	)
Accumulated deficit	(277,040)	)
Total stockholders' equity	\$ 800,399	\$

- (1) After deducting estimated underwriting discounts and commissions and estimated offering expenses payable by us, and assuming no exercise of the underwriters' over-allotment option to purchase up to an additional \_\_\_\_\_ shares of the Series C Preferred Stock.

**Table of Contents****DISTRIBUTIONS**

To maintain our qualification as a REIT, we must distribute substantially all of our taxable income to our stockholders for each year. We have done this in the past and intend to continue to do so in the future. We also have declared and paid regular quarterly dividends in the past and intend to do so in the future. We have adopted a dividend reinvestment plan to enable common stockholders to reinvest dividends automatically in additional shares of common stock.

The following table sets forth the cash distributions declared per share of our common stock, Series A Preferred Stock and Series B Preferred Stock during each fiscal quarter of our last four fiscal years.

	<b>Cash Distributions Declared</b>		<b>Cash Distributions Declared</b>	
	<b>Per Common</b>		<b>Per Series A Preferred</b>	<b>Per Series B Preferred</b>
	<b>Share</b>		<b>Share</b>	<b>Share</b>
<b><u>2014</u></b>				
First quarter	\$ 0.14	\$ 0.539063	\$ 0.390625	
Second quarter	\$ 0.14	\$ 0.539063	\$ 0.390625	
Third quarter	\$ 0.14	\$ 0.539063	\$ 0.390625	
Fourth quarter	\$ 0.14	\$ 0.539063	\$ 0.390625	
<b><u>2013</u></b>				
First quarter	\$ 0.15	\$ 0.539063	\$ 0.390625	
Second quarter	\$ 0.15	\$ 0.539063	\$ 0.390625	
Third quarter	\$ 0.12	\$ 0.539063	\$ 0.390625	
Fourth quarter	\$ 0.08	\$ 0.539063	\$ 0.390625	
<b><u>2012</u></b>				
First quarter	\$ 0.21	\$ 0.539063	\$ 0.390625	
Second quarter	\$ 0.18	\$ 0.539063	\$ 0.390625	
Third quarter	\$ 0.15	\$ 0.539063	\$ 0.390625	
Fourth quarter	\$ 0.15	\$ 0.539063	\$ 0.390625	
<b><u>2011</u></b>				
First quarter	\$ 0.25	\$ 0.539063	\$ 0.390625	
Second quarter	\$ 0.25	\$ 0.539063	\$ 0.390625	
Third quarter	\$ 0.23	\$ 0.539063	\$ 0.390625	
Fourth quarter	\$ 0.21	\$ 0.539063	\$ 0.390625	

We have not established a minimum distribution payment level on our common stock and our ability to pay distributions on our common stock or the Series C Preferred Stock may be adversely affected for the reasons described under the caption **Risk Factors** in this prospectus supplement, under the caption **Risk Factors** in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, which is incorporated by reference in the accompanying prospectus, and under the caption **Risk Factors** in the accompanying prospectus. All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our board of directors may deem relevant from time to time.



**Table of Contents****RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED DIVIDENDS**

The following table sets forth our ratios of earnings to combined fixed charges and preferred dividends for the periods shown:

	<b>For the Nine Months Ended September 30, 2014</b>	<b>For the Year Ended December 31,</b>				
		<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Ratio	1.55	1.77	2.09	2.29	2.09	2.07

The ratios of earnings to combined fixed charges and preferred dividends were computed by dividing earnings by fixed charges and preferred dividends. For this purpose, earnings consist of net income from continuing operations and fixed charges. Fixed charges consist of interest expense on all indebtedness. The ratios are based solely on historical financial information and no pro forma adjustments have been made thereto.

## **Table of Contents**

### **OUR COMPANY**

#### **General**

We were incorporated in Maryland on October 20, 1997 and we commenced operations on March 17, 1998. We are in the business of investing primarily in U.S. agency mortgage-backed securities (which we refer to as "Agency MBS"), which are securities representing obligations guaranteed by the U.S. government, such as Ginnie Mae, or federally sponsored enterprises, such as Fannie Mae or Freddie Mac. Our principal business objective is to generate net income for distribution to our stockholders based upon the spread between the interest income on our mortgage assets and the costs of borrowing to finance our acquisition of those assets.

We have elected to be taxed as a REIT under the Code. As long as we retain our REIT status, we generally will not be subject to federal or state taxes on our income to the extent that we distribute our taxable net income to our stockholders, and we routinely distribute to our stockholders substantially all of the taxable income generated from our operations. In order to qualify as a REIT, we must meet various ongoing requirements under the tax law, including requirements relating to the composition of our assets, the nature of our gross income, minimum distribution requirements, and requirements relating to the ownership of our stock. We believe that we have met all of these requirements, and that we will continue to qualify as a REIT.

In February of 2014, we incorporated our wholly-owned QRS, Anworth Properties, Inc., which commenced operations in March 2014. We incorporated Anworth Property Services, Inc., which we intend will elect to be treated as a TRS that is wholly-owned by the Company and currently not in operation. Our QRS will provide the entity through which we may own REIT-qualified real estate assets such as: (1) other types of mortgage assets, from which we would receive interest income; and (2) real estate assets, from which we would receive rental income and potential price appreciation. Our TRS will provide the entity through which we may participate in various activities that might otherwise have adverse tax consequences if conducted directly by a REIT or a QRS. Unlike a REIT, a TRS pays standard corporate taxes on its income earned from these activities in the mortgage and real estate markets. These other activities include almost everything other than receiving rent on properties owned and collecting interest on real estate mortgages owned. Examples of these other activities include: the securitization of mortgage loans; mortgage origination; leasing and managing rental properties; and owning properties acquired through the foreclosure process.

Pursuant to a Management Agreement (which we refer to as the "Management Agreement"), between us and Anworth Management, LLC (which we refer to as the "Manager"), effective as of December 31, 2011, our day-to-day operations are being conducted by the Manager. The Manager is supervised and directed by our board of directors and is responsible for (i) the selection, purchase and sale of our investment portfolio; (ii) our financing and hedging activities; and (iii) providing us with management services. The Manager will also perform such other services and activities relating to our assets and operations as may be appropriate. In exchange for these services, the Manager receives a management fee paid monthly in arrears in an amount equal to one-twelfth of 1.20% of our Equity (as defined in the Management Agreement). The term of the Management Agreement expired on December 31, 2013 and automatically renews for successive one-year renewal terms unless either party elects not to renew. If we terminate the Management Agreement, or elect not to renew without cause, then we will be required to pay a termination fee equal to three times the average annual management fee earned during the prior 24-month period. At September 30, 2014, if this hypothetical event had occurred, the termination fee would have been approximately \$34.8 million.

#### **Our Strategy**

##### *Investment Strategy*

Our strategy is to invest primarily in Agency MBS. We seek to acquire assets that will produce competitive returns after considering the amount and nature of the investment's anticipated returns, our ability to pledge the

S-24

## **Table of Contents**

investment to secure collateralized borrowings and the costs associated with financing, managing and reserving for these investments. We do not currently originate mortgage loans or provide other types of financing to the owners of real estate.

### *Financing Strategy*

We acquire MBS by primarily using short-term borrowings and, to a lesser extent, equity capital. We employ short-term borrowing to attempt to increase potential returns to our stockholders. Pursuant to our Capital and Leverage Policy, we seek to strike a balance between the under-utilization of leverage, which reduces potential returns to stockholders, and the over-utilization of leverage, which could reduce our ability to meet our obligations during adverse market conditions.

We usually borrow at short-term rates using repurchase agreements. Repurchase agreements are generally short-term in nature (less than or equal to twelve months). We actively manage the adjustment periods and the selection of the interest rate indices of our borrowings against the adjustment periods and the selection of the interest rate indices on our mortgage-related assets in order to lessen the liquidity and interest rate-related risks. We generally seek to diversify our exposure by entering into repurchase agreements with multiple lenders which are approved by our board of directors.

### *Growth Strategy*

It is our long-term objective to grow our earnings and our dividends per common share by increasing our paid-in capital and book value per share.

## **Our Operating Policies and Programs**

We have established the following four primary operating policies to implement our business strategies:

our Asset Acquisition Policy;

our Capital and Leverage Policy;

our Credit Risk Management Policy; and

our Asset/Liability Management Policy.

### *Asset Acquisition Policy*

Our Asset Acquisition Policy provides that we will invest primarily in U.S. Agency MBS and other mortgage assets rated within one of the two highest rating categories by at least one nationally recognized statistical rating organization.

Our Asset Acquisition Policy provides guidelines for acquiring investments and contemplates that we will acquire a portfolio of investments that can be grouped into specific categories. Each category and our respective investment

guidelines are as follows:

*Category I* At least 60% of our total assets will generally be adjustable- or fixed-rate MBS and short-term investments. Assets in this category will be rated within one of the two highest rating categories by at least one nationally recognized statistical rating organization or, if not rated, will be obligations guaranteed by the U.S. government or its agencies, such as Fannie Mae or Freddie Mac. Also included in Category I are the portion of real estate mortgage loans that have been deposited into a trust and have received a rating within one of the two highest rating categories by at least one nationally recognized statistical rating organization.

*Category II* At least 90% of our total assets will generally consist of Category I investments plus unsecuritized mortgage loans, mortgage securities rated at least investment grade by at least one

S-25



## **Table of Contents**

nationally recognized statistical rating organization, or shares of other REITs or mortgage-related companies and the portion of real estate mortgage loans that have been deposited into a trust and have received an investment grade rating by at least one nationally recognized statistical rating organization.

*Category III* No more than 10% of our total assets may be of a type not meeting any of the above criteria. Among the types of assets generally assigned to this category are mortgage securities rated below investment grade and leveraged mortgage derivative securities. Under our Category III investment criteria, we may acquire other types of mortgage derivative securities including, but not limited to, interest-only, principal-only or other types of MBS that receive a disproportionate share of interest income or principal.

### *Capital and Leverage Policy*

We employ a leverage strategy to increase our investment assets by borrowing against existing mortgage-related assets and using the proceeds to acquire additional mortgage-related assets. Relative to our investments in investment grade Agency MBS, we have generally borrowed, on a short-term basis, between seven to twelve times the amount of our equity allocated to these investments. During the past several years, we have borrowed, on a short-term basis, between five to nine times the amount of our equity allocated to these investments, as management believed it to be appropriate to lower our leverage due to the uncertainty in the financial marketplace and the broader problems in the economy. Our borrowings may vary from time to time depending on market conditions and other factors deemed relevant by our management and our board of directors. We believe that this will leave an adequate capital base to protect against interest rate environments in which our borrowing costs might exceed our interest income from mortgage-related assets. At December 31, 2013, our leverage on capital (including common stockholders' equity, all preferred stock and junior subordinated notes) was 8.1x.

Depending on the different costs of borrowing funds at different maturities, we may vary the maturities of our borrowed funds in an attempt to produce lower borrowing costs. Our borrowings are short-term and we manage actively, on an aggregate basis, both the interest rate indices and interest rate adjustment periods of our borrowings against the interest rate indices and interest rate adjustment periods on our mortgage-related assets.

Our mortgage-related assets are financed primarily at short-term borrowing rates through repurchase agreements. In the future, we may also employ borrowings under lines of credit and other collateralized financings that we may establish with approved institutional lenders.

### *Credit Risk Management Policy*

We review credit risk and other risks of loss associated with each of our potential investments. In addition, we may diversify our portfolio of mortgage-related assets to avoid undue geographic, insurer, industry and certain other types of concentrations.

Compliance with our Credit Risk Management Policy guidelines is determined at the time of purchase of mortgage-related assets based upon the most recent valuation utilized by us. Such compliance is not affected by events subsequent to such purchase including, without limitation, changes in characterization, value or rating of any specific mortgage assets or economic conditions or events generally affecting any mortgage-related assets of the type held by us.

### *Asset/Liability Management Policy*

*Interest Rate Risk Management.* To the extent consistent with our election to qualify as a REIT, we follow an interest rate risk management program intended to protect our portfolio of mortgage-related assets and related debt against the effects of major interest rate changes. Specifically, our interest rate management program is formulated with the intent to offset, to some extent, the potential adverse effects resulting from rate adjustment

S-26

## **Table of Contents**

limitations on our mortgage-related assets and the differences between interest rate adjustment indices and interest rate adjustment periods of our adjustable-rate mortgage-related assets and related borrowings.

Our interest rate risk management program encompasses a number of procedures including the following:

monitoring and adjusting, if necessary, the interest rate sensitivity of our mortgage-related assets compared with the interest rate sensitivities of our borrowings;

attempting to structure our borrowing agreements relating to adjustable-rate mortgage-related assets to have a range of different maturities and interest rate adjustment periods (although substantially all will be less than one year); and

actively managing, on an aggregate basis, the interest rate indices and interest rate adjustment periods of our mortgage-related assets compared to the interest rate indices and adjustment periods of our borrowings.

We expect to be able to adjust the average maturity/adjustment period of our borrowings on an ongoing basis by changing the mix of maturities and interest rate adjustment periods as borrowings come due or are renewed. Through the use of these procedures, we attempt to reduce the risk of differences between interest rate adjustment periods of our adjustable-rate mortgage-related assets and our related borrowings.

Depending on market conditions and the cost of the transactions, we may conduct certain hedging activities in connection with the management of our portfolio. To the extent consistent with our election to qualify as a REIT, we may adopt a hedging strategy intended to lessen the effects of interest rate changes and to enable us to earn net interest income in periods of generally rising, as well as declining or static, interest rates. Specifically, hedging programs are formulated with the intent to offset some of the potential adverse effects of changes in interest rate levels relative to the interest rates on the mortgage-related assets held in our investment portfolio and differences between the interest rate adjustment indices and periods of our mortgage-related assets and our borrowings. We monitor carefully, and may have to limit, our hedging activity to assure that we do not realize excessive hedging income or hold hedges having excess value in relation to our mortgage-related assets, which could result in our disqualification as a REIT or in the need to pay a penalty tax in order to maintain our qualification as a REIT. In addition, hedging activity involves transaction costs that increase dramatically as the period covered by hedging protection increases and that may increase during periods of fluctuating interest rates.

*Prepayment Risk Management.* We also seek to lessen the effects of prepayment of mortgage loans underlying our securities at a faster or slower rate than anticipated. We accomplish this by structuring a diversified portfolio with a variety of prepayment characteristics, investing in mortgage-related assets with prepayment prohibitions and penalties, investing in certain mortgage security structures that have prepayment protections and purchasing mortgage-related assets at a premium or at a discount. Under normal market conditions, we generally seek to maintain the aggregate capitalized purchase premium of the portfolio at 3.5% or less. In addition, we can purchase principal-only derivatives to a limited extent as a hedge against prepayment risks. We monitor prepayment risk through periodic review of the impact of a variety of prepayment scenarios on our revenues, net earnings, dividends, cash flow and net balance sheets market value.

We believe that we have developed cost-effective asset/liability management policies to mitigate prepayment risks. However, no strategy can completely insulate us from prepayment risks. Further, as noted above, certain of the federal

income tax requirements that we must satisfy to qualify as a REIT limit our ability to fully hedge our prepayment risks. Therefore, we could be prevented from effectively hedging our prepayment risks.

## **Our Investments**

### *Mortgage-Backed Securities ( MBS )*

*Pass-Through Certificates.* We principally invest in pass-through certificates, which are securities representing interests in pools of mortgage loans secured by residential real property in which payments of both

S-27

## **Table of Contents**

interest and principal on the securities are generally made monthly, in effect, passing through monthly payments made by the individual borrowers on the mortgage loans which underlie the securities, net of fees paid to the issuer or guarantor of the securities. Early repayment of principal on some MBS, arising from prepayments of principal due to sale of the underlying property, refinancing or foreclosure, net of fees and costs which may be incurred, may expose us to a lower rate of return upon reinvestment of principal. This is generally referred to as prepayment risk. Additionally, if a security subject to prepayment has been purchased at a premium, the unamortized value of the premium would be lost in the event of prepayment.

Like other fixed-income securities, when interest rates rise, the value of a mortgage-backed security generally will decline. When interest rates are declining, however, the value of MBS with prepayment features may not increase as much as other fixed-income securities. The rate of prepayments on underlying mortgages will affect the price and volatility of MBS and may have the effect of shortening or extending the effective maturity of the security beyond what was anticipated at the time of purchase. When interest rates rise, our holdings of MBS may experience reduced returns if the owners of the underlying mortgages pay off their mortgages later than anticipated. This is generally referred to as extension risk.

Payment of principal and interest on some mortgage pass-through securities, though not the market value of the securities themselves, may be guaranteed by the full faith and credit of the federal government, including securities backed by Ginnie Mae, or by agencies or instrumentalities of the federal government, including Fannie Mae and Freddie Mac. MBS created by non-governmental issuers, including commercial banks, savings and loan institutions, private mortgage insurance companies, mortgage bankers and other secondary market issuers, may be supported by various forms of insurance or guarantees including individual loan, title, pool and hazard insurance and letters of credit which may be issued by governmental entities, private insurers or the mortgage poolers. Essentially our entire portfolio is comprised of Agency MBS.

*Collateralized Mortgage Obligations.* Collateralized mortgage obligations (which we refer to as CMOs) are MBS. Interest and principal on CMOs are paid, in most cases, on a monthly basis. CMOs may be collateralized by whole mortgage loans, but are more typically collateralized by portfolios of mortgage pass-through securities. CMOs are structured into multiple classes with each class bearing a different stated maturity. Monthly payments of principal, including prepayments, are first returned to investors holding the shortest maturity class; investors holding the longer maturity classes receive principal only after the first class has been retired. We will typically consider investments in CMOs that are issued or guaranteed by the federal government, or by any of its agencies or instrumentalities, to be U.S. government securities. Investments in other CMOs are generally not treated as qualifying assets for purposes of the REIT asset requirements, and so our ability to invest in such CMOs is limited.

### *Other Types of MBS*

*Mortgage Derivative Securities.* We may acquire mortgage derivative securities in an amount not to exceed 10% of our total assets. Mortgage derivative securities provide for the holder to receive interest-only, principal-only or interest and principal in amounts that are disproportionate to those payable on the underlying mortgage loans. Payments on mortgage derivative securities are highly sensitive to the rate of prepayments on the underlying mortgage loans. In the event of faster or slower than anticipated prepayments on these mortgage loans, the rates of return on interests in mortgage derivative securities, representing the right to receive interest-only or a disproportionately large amount of interest or interest-only derivatives, would be likely to decline or increase, respectively. Conversely, the rates of return on mortgage derivative securities, representing the right to receive principal-only or a disproportionate amount of principal or principal-only derivatives, would be likely to increase or decrease in the event of faster or slower prepayments, respectively.

We may invest in inverse floaters, a class of CMOs with a coupon rate that resets in the opposite direction from the market rate of interest to which it is indexed, including LIBOR or the 11th District Cost of Funds Index (which we refer to as COFI ). Any rise in the index rate, which can be caused by an increase in interest rates,

S-28

**Table of Contents**

causes a drop in the coupon rate of an inverse floater, while any drop in the index rate causes an increase in the coupon of an inverse floater. An inverse floater may behave like a leveraged security since its interest rate usually varies by a magnitude much greater than the magnitude of the index rate of interest. The leverage-like characteristics inherent in inverse floaters result in a greater volatility of their market prices.

We may invest in other mortgage derivative securities that may be developed in the future.

*Mortgage Warehouse Participations.* We may occasionally acquire mortgage warehouse participations as an additional means of diversifying our sources of income. We anticipate that these investments, together with our investments in other Category III assets, will not, in the aggregate, exceed 10% of our total mortgage-related assets. These investments are participations in lines of credit to mortgage loan originators secured by recently originated mortgage loans that are in the process of being sold to investors. Our investments in mortgage warehouse participations are limited because they are not qualified REIT assets under the Code.

*Other Mortgage-Related Assets*

We may acquire other investments that include equity and debt securities issued by other primarily mortgage-related finance companies, interests in mortgage-related collateralized bond obligations, other subordinated interests in pools of mortgage-related assets, commercial mortgage loans and securities and residential mortgage loans other than high-credit quality mortgage loans.

We expect that our other investments in Category III assets under our Asset Acquisition Policy will be less than 10% of total assets. However, there is no stated limit as to how much these investments will be allocated related to our stockholders' equity. There may be periods in which other investments represent a large portion of our stockholders' equity.

**Table of Contents**

**DESCRIPTION OF SERIES C PREFERRED STOCK**

*The following summary of the terms and provisions of the Series C Preferred Stock does not purport to be complete and is qualified in its entirety by reference to our charter and the articles supplementary establishing the Series C Preferred Stock, each of which is incorporated by reference in this prospectus supplement and the accompanying prospectus. This description of the particular terms of the Series C Preferred Stock supplements and, to the extent inconsistent therewith, supersedes the description of the general terms and provisions of our preferred stock set forth in the accompanying prospectus. If the description of the Series C Preferred Stock in this prospectus supplement differs from the general description of our preferred stock in the accompanying prospectus, you should rely on the information in this prospectus supplement.*

**General**

We are authorized to issue up to 20,000,000 shares of preferred stock from time to time, in one or more series or classes, with such designations, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption, in each case, if any, as are permitted by Maryland law and as our board of directors may determine prior to issuance thereof by adoption of articles supplementary to our charter without any further vote or action by our stockholders.

**Ranking**

The Series C Preferred Stock ranks senior to our common stock with respect to the payments of distributions and rights to payment upon liquidation, dissolution or winding up. The Series C Preferred Stock ranks on parity with all other series of preferred stock that we may issue ranking on par with the Series C Preferred Stock, including our Series A Preferred Stock and Series B Preferred Stock, with respect to the payments of distributions and rights to payment upon liquidation, dissolution or winding up. We refer to such series of parity preferred stock as Parity Preferred.

**Dividends**

Holders of the Series C Preferred Stock (which we refer to as Series C Preferred Stockholders) are entitled to receive, when and as authorized by our board of directors, out of funds legally available for the payment of dividends, cumulative preferential cash dividends at the rate of 7.625% per annum of the \$25.00 liquidation preference (equivalent to \$1.90625 per share). Such dividends will be cumulative from January 1, 2015 for shares issued in this offering, and will be payable to investors quarterly in arrears on the 15th day of January, April, July and October of each year or, if not a business day, the next succeeding business day (each, a Dividend Payment Date). The first dividend for shares issued in this offering will be payable on April 15, 2015 and will be for less than the full quarterly dividend period. Any dividend payable on the Series C Preferred Stock for any partial dividend period will be computed on the basis of a 360-day year consisting of twelve 30-day months. Dividends will be payable to holders of record as they appear on our records at the close of business on the last day of each of March, June, September and December, as the case may be, immediately preceding the applicable Dividend Payment Date (each, a Dividend Record Date). Series C Preferred Stockholders will not be entitled to receive any dividends in excess of cumulative dividends on the Series C Preferred Stock. No interest will be paid in respect of any dividend payment or payments on the Series C Preferred Stock that may be in arrears.

No dividends on shares of Series C Preferred Stock will be declared by us or paid or set apart for payment by us at such time as the terms and provisions of any of our agreements, including any agreement relating to our indebtedness, prohibit such declaration, payment or setting apart for payment or provide that such declaration, payment or setting



apart for payment would constitute a breach thereof or a default thereunder, or if such declaration or payment will be restricted or prohibited by law.

S-30

## **Table of Contents**

Notwithstanding the foregoing, dividends on the Series C Preferred Stock will accrue whether or not we have earnings, whether or not there are funds legally available for the payment of such dividends and whether or not such dividends are declared. Accrued and unpaid dividends on the Series C Preferred Stock will accumulate as of the Dividend Payment Date on which they first become payable.

Except as set forth in the next paragraph, unless full cumulative dividends on the Series C Preferred Stock have been or contemporaneously are declared and paid or declared and a sum sufficient for such full payment is set apart for payment for all past dividend periods and the then current dividend period, no dividends (other than dividends in shares of common stock or dividends in shares of any series of preferred stock that we may issue ranking junior to the Series C Preferred Stock as to dividends and upon liquidation) will be declared or paid or set aside for payment. Nor will any other distribution be declared or made upon shares of our common stock or preferred stock that we may issue ranking junior to or on par with the Series C Preferred Stock as to dividends or upon liquidation. In addition, any shares of our common stock or preferred stock that we may issue ranking junior to or on par with the Series C Preferred Stock as to dividends or upon liquidation will not be redeemed, purchased or otherwise acquired for any consideration (or any moneys be paid to or made available for a sinking fund for the redemption of any such shares) by us (except by conversion into or exchange for our other capital stock that we may issue ranking junior to the Series C Preferred Stock as to dividends and upon liquidation and except for transfers made pursuant to the provisions of our charter relating to restrictions on ownership and transfers of our capital stock).

If dividends are not paid in full (or a sum sufficient for such full payment is not so set apart) upon the Series C Preferred Stock and the shares of any other series of Parity Preferred, all dividends declared upon the Series C Preferred Stock and the shares of any other series of Parity Preferred will be declared pro rata so that the amount of dividends declared per share of the Series C Preferred Stock and the shares of any other series of Parity Preferred will in all cases bear to each other the same ratio that accrued dividends per share on the Series C Preferred Stock and the shares of any other series of Parity Preferred (which will not include any accrual in respect of unpaid dividends for prior dividend periods if such preferred stock does not have a cumulative dividend) bear to each other. No interest, or sum of money in lieu of interest, will be payable in respect of any dividend payment or payments on the Series C Preferred Stock which may be in arrears.

Series C Preferred Stockholders will not be entitled to any dividend, whether payable in cash, property or stock, in excess of full cumulative dividends on the Series C Preferred Stock as provided above. Any dividend payment made on shares of the Series C Preferred Stock will first be credited against the earliest accrued and unpaid dividend due with respect to such shares which remains payable.

## **Liquidation Preference**

Upon any voluntary or involuntary liquidation, dissolution or winding up of our affairs, the Series C Preferred Stockholders are entitled to be paid out of our assets that are legally available for distribution to our stockholders a liquidation preference of \$25.00 per share, plus an amount equal to any accrued and unpaid dividends (whether or not declared) to the date of payment, before any distribution of assets is made to our common stockholders or to holders of any series of our preferred stock that we may issue that ranks junior to the Series C Preferred Stock as to liquidation rights.

In the event that, upon any such voluntary or involuntary liquidation, dissolution or winding up, our available assets are insufficient to pay the amount of the liquidating distributions on all outstanding shares of Series C Preferred Stock and the corresponding amounts payable on all shares of other classes or series of Parity Preferred, then the Series C Preferred Stockholders and stockholders of such classes or series of Parity Preferred will share ratably in any such distribution of assets in proportion to the full liquidating distributions to which they would otherwise be respectively

entitled.

Series C Preferred Stockholders will be entitled to written notice of any such liquidation. After payment of the full amount of the liquidating distributions to which they are entitled, the Series C Preferred Stockholders will

S-31

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**Table of Contents**

have no right or claim to any of our remaining assets. The consolidation or merger of us with or into any other corporation, trust or entity or of any other corporation with or into us, or the sale, lease or conveyance of all or substantially all of our assets or business, will not be deemed to constitute a liquidation, dissolution or winding up of us.

**Voting Rights**

The Series C Preferred Stockholders do not have any voting rights, except as set forth below.

Whenever dividends on any shares of Series C Preferred Stock are in arrears for six or more quarterly periods (whether or not consecutive) (which we refer to as a Preferred Dividend Default ), the number of directors then constituting our board of directors will be increased by two (if not already increased by two by reason of the election of directors by the holders of other series of Parity Preferred), and the Series C Preferred Stockholders (voting separately as a class with all other series of Parity Preferred upon which like voting rights have been conferred and are exercisable) will be entitled to elect the two additional members of our board of directors (which we refer to as Preferred Stock Directors ) at a special meeting called by the holders of record of at least 10% of the Series C Preferred Stock or any other series of Parity Preferred so in arrears (unless such request is received less than 90 days before the date fixed for the next annual or special meeting of the stockholders) or at the next annual meeting of stockholders, and at each subsequent annual meeting until all dividends accumulated on such shares of Series C Preferred Stock for the past dividend periods and the dividends for all dividend periods during the two most recently completed quarterly periods have been fully paid or declared and sums sufficient for the payments thereof have been set aside for payment.

If and when all accumulated dividends and the dividends for all dividend periods during the two most recently completed quarterly periods on the Series C Preferred Stock have been paid in full or set aside for payment in full, the Series C Preferred Stockholders will be divested of the foregoing voting rights (subject to revesting in the event of each and every subsequent Preferred Dividend Default) and, if all accumulated dividends and the dividends for all dividend periods during the two most recently completed quarterly periods have been paid in full or set aside for payment in full on all series of Parity Preferred upon which like voting rights have been conferred and are exercisable, the term of office of each Preferred Stock Director so elected will terminate and the number of directors on the board of directors will decrease by two. Any Preferred Stock Director may be removed at any time with or without cause by, and will not be removed otherwise than by the vote of, the holders of record of a majority of the outstanding shares of the Series C Preferred Stock when they have the voting rights described above (voting separately as a class with all series of Parity Preferred that we may issue upon which like voting rights have been conferred and are exercisable). So long as a Preferred Dividend Default continues, any vacancy in the office of a Preferred Stock Director may be filled by the written consent of the Preferred Stock Directors remaining in office, or if none remains in office, by a vote of the holders of record of a majority of the outstanding shares of Series C Preferred Stock when they have the voting rights described above (voting separately as a class with all series of Parity Preferred that we may issue upon which like voting rights have been conferred and are exercisable). The Preferred Stock Directors will each be entitled to one vote per director on any matter.

So long as any shares of Series C Preferred Stock remain outstanding, we will not, without the affirmative vote or consent of the holders of at least two-thirds of the shares of the Series C Preferred Stock outstanding at the time, given in person or by proxy, either in writing or at a meeting (voting separately as a class with all series of Parity Preferred that we may issue upon which like voting rights have been conferred and are exercisable), (i) authorize or create, or increase the authorized or issued amount of, any class or series of capital stock ranking senior to the Series C Preferred Stock with respect to payment of dividends or the distribution of assets upon liquidation, dissolution or winding up or reclassify any of our authorized capital stock into such shares, or create, authorize or issue any obligation or security convertible into or evidencing the right to purchase any such shares; or (ii) amend, alter or

repeal the provisions of our charter, whether by merger, consolidation or otherwise (which we refer to as an Event ), so as to materially and adversely affect any right, preference, privilege or voting

S-32

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**Table of Contents**

power of the Series C Preferred Stock; provided, however, with respect to the occurrence of any Event set forth in (ii) above, so long as the Series C Preferred Stock remains outstanding with the terms thereof materially unchanged, the occurrence of any such Event will not be deemed to materially and adversely affect such rights, preferences, privileges or voting power of Series C Preferred Stockholders and, provided further, that any increase in the amount of the authorized preferred stock, including the Series C Preferred Stock, or the creation or issuance of any additional Series C Preferred Stock or other series of preferred stock that we may issue, or any increase in the amount of authorized shares of such series, in each case ranking on a parity with or junior to the Series C Preferred Stock that we may issue with respect to payment of dividends or the distribution of assets upon liquidation, dissolution or winding up, will not be deemed to materially and adversely affect such rights, preferences, privileges or voting powers.

**Maturity**

The Series C Preferred Stock has no maturity date and is not subject to any sinking fund or mandatory redemption. Accordingly, the Series C Preferred Stock will remain outstanding indefinitely unless we redeem it pursuant to the circumstances described under Redemption Optional Redemption or Special Optional Redemption below, or, if we do not redeem it, you elect to convert it following a Change of Control pursuant to the circumstances described under Conversion Rights of Series C Preferred Stockholders below.

**Redemption**

Except as described below under Special Optional Redemption, the Series C Preferred Stock is not redeemable prior to January 1, 2020.

*Optional Redemption*

On and after January 1, 2020, we may, at our option, upon not less than 30 nor more than 60 days written notice, redeem the Series C Preferred Stock, in whole or in part, at any time or from time to time, for cash at a redemption price of \$25.00 per share, plus any accrued and unpaid dividends thereon to, but not including, the date fixed for redemption. If we elect to redeem any shares of Series C Preferred Stock as described in this paragraph, we may use any available cash to pay the redemption price, and we will not be required to pay the redemption price only out of the proceeds from the issuance of other equity securities or any other specific source.

*Special Optional Redemption*

Upon the occurrence of a Change of Control (as defined below), we may, at our option, upon not less than 30 nor more than 60 days written notice, redeem the Series C Preferred Stock, in whole or in part, within 120 days after the first date on which such Change of Control occurred, for cash at a redemption price of \$25.00 per share, plus any accrued and unpaid dividends thereon to, but not including, the date fixed for redemption. If we elect to redeem any shares of the Series C Preferred Stock as described in this paragraph, we may use any available cash to pay the redemption price, and we will not be required to pay the redemption price only out of the proceeds from the issuance of other equity securities or any other specific source.

If, prior to the Change of Control Conversion Date (as defined below under Conversion Rights of Series C Preferred Stockholders Certain Definitions ), we have provided notice of our election to redeem some or all of the shares of Series C Preferred Stock (whether pursuant to our optional redemption right described above under Optional Redemption above or this special optional redemption right), the Series C Preferred Stockholders will not have the Change of Control Conversion Right (as defined and described below under Conversion Rights of Series C Preferred Stockholders ) with respect to the shares of Series C Preferred Stock called for redemption.

S-33

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**Table of Contents**

A Change of Control is deemed to occur when, after the original issuance of the Series C Preferred Stock, the following have occurred and are continuing:

1. (a) any person or group (as such terms are used in Sections 13(d) and 14(d) of the Exchange Act) acquires the beneficial ownership, directly or indirectly, through a purchase, merger or other acquisition transaction or series of transactions, of 50% or more of the total voting power of our total outstanding voting stock other than an acquisition by us or any of our subsidiaries;
  - (b) we consolidate with, or merge with or into, another person or convey, transfer, lease or otherwise dispose of all or substantially all of our assets to any person, or any person consolidates with or merges with or into us, other than: (a) any transaction (i) that does not result in any reclassification, exchange, or cancellation of outstanding shares of our capital stock and (ii) pursuant to which our capital stockholders immediately prior to the transaction have the entitlement to exercise, directly or indirectly, 50% or more of the total voting power of all shares of our capital stock entitled to vote generally in the election of directors of the continuing or surviving person immediately after the transaction; or (b) any merger solely for the purpose of changing our jurisdiction of formation and resulting in a reclassification, conversion or exchange of outstanding shares of common stock solely into shares of common stock of the surviving entity; or
  - (c) we approve a plan of liquidation or dissolution; and
2. following the closing of any transaction referred to in (1) above, neither we nor the acquiring or surviving entity has a class of common securities listed for trading on a United States national securities exchange (including the Nasdaq Stock Market).

The definition of Change of Control includes a phrase relating to the conveyance, transfer, sale, lease or other disposition of all or substantially all of our assets. There is no precise, established definition of the phrase substantially all under the laws of the State of Maryland, which govern the Series C Preferred Stock, and our formation.

Accordingly, our ability to redeem all or part of the Series C Preferred Stock as a result of a conveyance, transfer, sale, lease or other disposition of less than all of our assets may be uncertain.

*Redemption Procedures*

In the event we elect to redeem Series C Preferred Stock, the notice of redemption will be mailed, not less than 30 nor more than 60 days prior to the redemption date, to each holder of record of Series C Preferred Stock called for redemption at such holder's address as it appears on our stock transfer records and will state the following:

the redemption date;

the number of shares of Series C Preferred Stock to be redeemed (if less than all of the Series C Preferred Stock held by any Series C Preferred Stockholder are to be redeemed, the notice shall specify the number of



shares of Series C Preferred Stock held by such holder to be redeemed);

the redemption price;

the procedure for surrendering shares of Series C Preferred Stock to be redeemed for payment of the redemption price;

that dividends on the shares of Series C Preferred Stock to be redeemed will cease to accumulate on the redemption date;

whether such redemption is being made pursuant to the provisions described above under Optional Redemption or Special Optional Redemption above;

if applicable, that such redemption is being made in connection with a Change of Control and, in that case, a brief description of the transaction or transactions constituting such Change of Control; and

S-34

**Table of Contents**

if such redemption is being made in connection with a Change of Control, that the Series C Preferred Stockholders being so called for redemption will not be able to tender such shares of Series C Preferred Stock for conversion in connection with the Change of Control, and that each share of Series C Preferred Stock tendered for conversion that is called, prior to the Change of Control Conversion Date, for redemption will be redeemed on the related date of redemption instead of converted on the Change of Control Conversion Date.

No failure to give such notice or any defect thereto or in the mailing thereof shall affect the validity of the proceedings for the redemption of any shares of Series C Preferred Stock except as to the holder to whom notice was defective or not given. Any such redemption may be made conditional on such factors as may be determined by our board of directors and as set forth in the notice of redemption.

Series C Preferred Stockholders to be redeemed shall follow the procedures for surrendering the Series C Preferred Stock set forth in the notice of redemption and shall be entitled to the redemption price and any accrued and unpaid dividends payable upon the redemption following the surrender.

If notice of redemption of any shares of Series C Preferred Stock has been given and if we have irrevocably set aside the funds necessary for redemption in trust for the benefit of the holders of the shares of Series C Preferred Stock so called for redemption, then from and after the redemption date (unless we shall default in providing for the payment of the redemption price plus any accrued and unpaid dividends), dividends will cease to accrue on those shares of Series C Preferred Stock, those shares of Series C Preferred Stock shall no longer be deemed outstanding, and all rights of the holders of those shares will terminate, except the right to receive the redemption price plus any accrued and unpaid dividends payable upon redemption.

If any redemption date is not a business day, then the redemption price and any accrued and unpaid dividends payable upon redemption may be paid on the next business day and no interest, additional dividends or other sums will accrue on the amount payable for the period from and after that redemption date to that next business day.

If less than all of the outstanding Series C Preferred Stock is to be redeemed, the Series C Preferred Stock to be redeemed shall be selected pro rata (as nearly as may be practicable without creating fractional shares).

Immediately prior to any redemption of Series C Preferred Stock, we shall pay, in cash, any accrued and unpaid dividends through and including the redemption date, unless a redemption date falls after a Dividend Record Date and prior to the corresponding Dividend Payment Date, in which case each Series C Preferred Stockholder at the close of business on such Dividend Record Date shall be entitled to the dividend payable on such shares on the corresponding Dividend Payment Date notwithstanding the redemption of such shares before such Dividend Payment Date. Except as provided above, we will make no payment or allowance for unpaid dividends, whether or not in arrears, on shares of the Series C Preferred Stock to be redeemed.

Unless full cumulative dividends on all shares of Series C Preferred Stock have been or contemporaneously are declared and paid or declared and a sum sufficient for the payment thereof has been or contemporaneously is set apart for payment for all past dividend periods, no shares of Series C Preferred Stock shall be redeemed unless all outstanding shares of Series C Preferred Stock are simultaneously redeemed, and we shall not purchase or otherwise acquire directly or indirectly any shares of Series C Preferred Stock (except by exchanging it for our capital stock ranking junior to the Series C Preferred Stock as to dividends and upon liquidation); provided, however, that the foregoing shall not prevent the purchase or acquisition by us of shares of Series C Preferred Stock to preserve our REIT status or pursuant to a purchase or exchange offer made on the same terms to holders of all outstanding shares of Series C Preferred Stock.

In connection with any redemption of the Series C Preferred Stock, we will comply with all U.S. federal and state securities laws in connection with any redemption by us of the Series C Preferred Stock. In addition, subject

S-35

## **Table of Contents**

to applicable law, we may purchase shares of Series C Preferred Stock in the open market, by tender or by private agreement. Any shares of Series C Preferred Stock redeemed, purchased or otherwise acquired by us in any manner whatsoever may be retired and re-classified as authorized but unissued shares of preferred stock, without designation as to class or series, and may thereafter be reissued by us as any class or series of preferred stock in accordance with the applicable provisions of our charter.

### **Conversion Rights of Series C Preferred Stockholders**

Upon the occurrence of a Change of Control, each Series C Preferred Stockholder will have the right (unless, prior to the Change of Control Conversion Date, we have provided notice of our election to redeem some or all of the shares of Series C Preferred Stock held by such holder as described above under Redemption Optional Redemption or Redemption Special Optional Redemption above, in which case such holder will have the right only with respect to any shares of Series C Preferred Stock that are not called for redemption) to convert some or all of the shares of Series C Preferred Stock held by such holder (which we refer to as the Change of Control Conversion Right ) on the Change of Control Conversion Date into a number of shares of our common stock per share of Series C Preferred Stock (which we refer to as the Common Stock Conversion Consideration ) equal to the lesser of:

- (i) the quotient obtained by dividing (A) the sum of the \$25.00 liquidation preference per share of Series C Preferred Stock plus the amount of any accrued and unpaid dividends thereon to, but not including, the Change of Control Conversion Date (unless the Change of Control Conversion Date is after a Dividend Record Date and prior to the corresponding Dividend Payment Date for the Series C Preferred Stock, in which case no additional amount for such accrued and unpaid dividends will be included in this sum) by (B) the Common Stock Price (as defined below); and

- (ii) (which we refer to as the Share Cap ), subject to certain adjustments as described below.

#### *Share Cap Adjustments*

The Share Cap is subject to pro rata adjustments for any share splits (including those effected pursuant to a distribution of our common stock to existing holders of our common stock), subdivisions or combinations (in each case, a Share Split ) with respect to our common stock as follows: the adjusted Share Cap as the result of a Share Split will be the number of shares of our common stock that is equivalent to the product obtained by multiplying (i) the Share Cap in effect immediately prior to such Share Split by (ii) a fraction, the numerator of which is the number of shares of our common stock outstanding immediately after giving effect to such Share Split and the denominator of which is the number of shares of our common stock outstanding immediately prior to such Share Split.

For the avoidance of doubt, subject to the immediately succeeding sentence, the aggregate number of shares of our common stock (or equivalent Alternative Conversion Consideration (as defined below), as applicable) issuable or deliverable, as applicable, in connection with the exercise of the Change of Control Conversion Right will not exceed shares of our common stock (or equivalent Alternative Conversion Consideration, as applicable), subject to proportionate increase to the extent the underwriters over-allotment option to purchase additional shares of Series C Preferred Stock is exercised, not to exceed shares of our common stock in total (or equivalent Alternative Conversion Consideration, as applicable) (which we refer to as the Exchange Cap ). The Exchange Cap is subject to pro rata adjustments for any Share Splits on the same basis as the corresponding adjustment to the Share Cap.

#### *Conversion Consideration*

In the case of a Change of Control pursuant to which our common stock is or will be converted into cash, securities or other property or assets (including any combination thereof) (which we refer to as the Alternative Form Consideration ), a Series C Preferred Stockholder will receive upon conversion of such Series C Preferred

S-36

## **Table of Contents**

Stock the kind and amount of Alternative Form Consideration which such holder would have owned or been entitled to receive upon the Change of Control had such holder held a number of shares of our common stock equal to the Common Stock Conversion Consideration immediately prior to the effective time of the Change of Control (which we refer to as the Alternative Conversion Consideration, and we refer to the Common Stock Conversion Consideration or the Alternative Conversion Consideration, whichever shall be applicable to a Change of Control, as the Conversion Consideration ).

If the holders of our common stock have the opportunity to elect the form of consideration to be received in the Change of Control, the Conversion Consideration in respect of such Change of Control will be deemed to be the kind and amount of consideration actually received by holders of a majority of the outstanding shares of our common stock that made or voted for such an election if electing between two types of consideration, or holders of a plurality of the outstanding shares of our common stock that made or voted for such an election if electing between more than two types of consideration, as the case may be, and will be subject to any limitations to which all holders of our common stock are subject, including, without limitation, pro rata reductions applicable to any portion of the consideration payable in such Change of Control.

We will not issue any fractional shares of our common stock upon the conversion of the Series C Preferred Stock in connection with a Change of Control. Instead, we will make a cash payment equal to the value of such fractional shares based upon the Common Stock Price used in determining the Common Stock Conversion Consideration for such Change of Control.

### *Conversion Procedures*

Within 15 days following the occurrence of a Change of Control, provided that we have not then exercised our right to redeem all shares of Series C Preferred Stock pursuant to the redemption provisions described above, we will provide to the Series C Preferred Stockholders a notice of occurrence of the Change of Control that describes the resulting Change of Control Conversion Right. This notice will state the following:

the events constituting the Change of Control;

the date of the Change of Control;

the last date on which the Series C Preferred Stockholders may exercise their Change of Control Conversion Right;

the method and period for calculating the Common Stock Price;

the Change of Control Conversion Date;

that if, prior to the Change of Control Conversion Date, we have provided notice of our election to redeem any or all shares of Series C Preferred Stock, holders will not be able to convert such shares of Series C

Preferred Stock called for redemption and such shares will be redeemed on the applicable redemption date, even if such shares have already been tendered for conversion pursuant to the Change of Control Conversion Right;

if applicable, the type and amount of Alternative Conversion Consideration entitled to be received per share of Series C Preferred Stock;

the name and address of the paying agent, transfer agent and conversion agent for the Series C Preferred Stock;

the procedures that the Series C Preferred Stockholders must follow to exercise the Change of Control Conversion Right (including procedures for surrendering shares for conversion through the facilities of DTC, including the form of conversion notice to be delivered by such holders as described below; and

the last date on which Series C Preferred Stockholders may withdraw shares surrendered for conversion and the procedures that such holders must follow to effect such a withdrawal.

S-37

## **Table of Contents**

Under such circumstances, we will also issue a press release containing such notice for publication on Dow Jones & Company, Inc., Business Wire, PR Newswire or Bloomberg Business News (or, if these organizations are not in existence at the time of issuance of the press release, such other news or press organization as is reasonably calculated to broadly disseminate the relevant information to the public), and post a notice on our website, in any event prior to the opening of business on the first business day following any date on which we provide the notice described above to the Series C Preferred Stockholders.

To exercise the Change of Control Conversion Right, Series C Preferred Stockholders will be required to deliver, on or before the close of business on the Change of Control Conversion Date, the shares of Series C Preferred Stock to be converted through the facilities of DTC, together with a written conversion notice in the form provided by us, duly completed, to our transfer agent. The conversion notice must comply with applicable procedures, if any, of DTC and state:

the relevant Change of Control Conversion Date;

the number of shares of Series C Preferred Stock to be converted; and

that the Series C Preferred Stock is to be converted pursuant to the applicable provisions of the Series C Preferred Stock

Series C Preferred Stockholders may withdraw any notice of exercise of a Change of Control Conversion Right (in whole or in part) by a written notice of withdrawal delivered to our transfer agent prior to the close of business on the business day prior to the Change of Control Conversion Date. The notice of withdrawal delivered by any holder must comply with applicable procedures, if any, of DTC and state:

the number of withdrawn shares of Series C Preferred Stock; and

the number of shares of Series C Preferred Stock, if any, which remain subject to such holder's conversion notice.

Series C Preferred Stock as to which the Change of Control Conversion Right has been properly exercised and for which the conversion notice has not been properly withdrawn will be converted into the applicable Conversion Consideration in accordance with the Change of Control Conversion Right on the Change of Control Conversion Date, unless prior to the Change of Control Conversion Date we have provided notice of our election to redeem some or all of the shares of Series C Preferred Stock, as described above under Redemption Optional Redemption or

Redemption Special Optional Redemption, in which case only the shares of Series C Preferred Stock properly surrendered for conversion and not properly withdrawn that are not called for redemption, if any, will be converted as aforesaid. If we elect to redeem shares of Series C Preferred Stock that would otherwise be converted into the applicable Conversion Consideration on a Change of Control Conversion Date, such shares of Series C Preferred Stock will not be so converted and the holders of such shares will be entitled to receive on the applicable redemption date the redemption price described above under Redemption Optional Redemption or Redemption Special Optional Redemption, as applicable.



We will deliver all securities, cash and any other property owing upon conversion no later than the third business day following the Change of Control Conversion Date. Notwithstanding the foregoing, the persons entitled to receive any shares of our common stock or other securities delivered on conversion will be deemed to have become the holders of record thereof as of the Change of Control Conversion Date.

In connection with the exercise of any Change of Control Conversion Right, we will comply with all federal and state securities laws and stock exchange rules in connection with any conversion of Series C Preferred Stock into shares of our common stock or other property. Notwithstanding any other provision of the Series C Preferred Stock, no Series C Preferred Stockholder will be entitled to convert such Series C Preferred Stock into shares of our common stock to the extent that receipt of such common stock would cause such holder (or any other person) to exceed the applicable share ownership limitations contained in our charter or the articles supplementary establishing the Series C Preferred Stock, unless we provide an exemption from this limitation to such holder. See [Restrictions on Ownership](#) below and [Description of Our Capital Stock](#) [Restrictions on Transfer](#) in the accompanying prospectus.

S-38

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**Table of Contents**

*Payment of Dividends Upon Conversion*

Anything in the articles supplementary establishing the Series C Preferred Stock to the contrary notwithstanding and except as otherwise required by law, the persons who are the holders of record of shares of Series C Preferred Stock at the close of business on a Dividend Record Date will be entitled to receive the dividend payable on the corresponding Dividend Payment Date notwithstanding the conversion of those shares after such Dividend Record Date and on or prior to such Dividend Payment Date, and, in such case, the full amount of such dividend shall be paid on such Dividend Payment Date to the persons who were the holders of record at the close of business on such Dividend Record Date. Except as provided above, we will make no allowance for unpaid dividends that are not in arrears on the shares of Series C Preferred Stock to be converted.

*Certain Definitions*

The **Change of Control Conversion Date** is the date the Series C Preferred Stock is to be converted, which will be a business day selected by us that is no fewer than 20 days nor more than 35 days after the date on which we provide the notice described under **Conversion Procedures** above to the Series C Preferred Stockholders.

The **Common Stock Price** is (i) if the consideration to be received in the Change of Control by the holders of our common stock is solely cash, the amount of cash consideration per share of our common stock, or (ii) if the consideration to be received in the Change of Control by holders of our common stock is other than solely cash, (A) the average of the closing sale prices per share of our common stock (or, if no closing sale price is reported, the average of the closing bid and ask prices per share or, if more than one in either case, the average of the average closing bid and the average closing ask prices per share) for the ten consecutive trading days immediately preceding, but not including, the date on which such Change of Control occurred as reported on the principal United States national securities exchange on which our common stock is then traded, or (B) the average of the last quoted bid prices for our common stock in the over-the-counter market as reported by Pink OTC Markets Inc. or another similar organization for the ten consecutive trading days immediately preceding, but not including, the date on which such Change of Control occurred, if our common stock is not then listed for trading on a United States national securities exchange.

**Information Rights**

During any period in which we are not subject to Section 13 or 15(d) of the Exchange Act and any shares of Series C Preferred Stock are outstanding, we will use our best efforts to (i) transmit by mail (or other permissible means under the Exchange Act) to all Series C Preferred Stockholders, as their names and addresses appear on our record books and without cost to such holders, copies of the annual reports on Form 10-K and quarterly reports on Form 10-Q that we would have been required to file with the SEC pursuant to Section 13 or 15(d) of the Exchange Act if we were subject thereto (other than any exhibits that would have been required), and (ii) promptly, upon request, supply copies of such reports to any current or prospective Series C Preferred Stockholder, subject to certain exceptions described in this prospectus supplement. We will use our best efforts to mail (or otherwise provide) the information to the Series C Preferred Stockholders within 15 days after the respective dates by which a periodic report on Form 10-K or Form 10-Q, as the case may be, in respect of such information would have been required to be filed with the SEC, if we were subject to Section 13 or 15(d) of the Exchange Act, in each case, based on the dates on which we would be required to file such periodic reports if we were a non-accelerated filer within the meaning of the Exchange Act.

**Transfer and Dividend Paying Agent**

American Stock Transfer & Trust Company will act as the transfer and dividend paying agent and registrar in respect of the Series C Preferred Stock.

S-39

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**Table of Contents**

**Restrictions on Ownership**

For us to maintain our qualification as a REIT under the Code, our shares of capital stock must be beneficially owned by 100 or more persons during at least 335 days of a taxable year of 12 months (or during a proportionate part of a shorter taxable year). Also, not more than 50% in value of our outstanding shares of capital stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities) during the last half of a taxable year. To assist us in complying with those share ownership rules, our charter contains provisions that restrict the ownership and transfer of our shares of capital stock. With certain exceptions, our charter prohibits direct or constructive ownership by any person of more than 9.8% (in value or number of shares, whichever is more restrictive) of the outstanding shares of our common stock, or, with respect to any class or series of preferred stock, 9.8% (in value or number of shares, whichever is more restrictive) of the outstanding shares of such class or series of preferred stock, including the Series C Preferred Stock, and no person or entity may own, directly or constructively, more than 9.8% of the value of our outstanding shares of capital stock. If any transfer of shares of the Series C Preferred Stock or other capital stock occurs (including the acquisition of common stock upon a conversion of the Series C Preferred Stock) which, if effective, would result in any person owning, directly or indirectly, shares of our capital stock in violation of the ownership limits set forth above, then that number of shares which would cause the violation will be automatically transferred to a trust for the benefit of a charitable beneficiary, or if the transfer to the trust would not be effective for any reason to prevent the violation of the ownership limit, then the transfer of that number of shares which would cause the violation will be void *ab initio* and the intended transferee will not acquire any rights in such shares of capital stock. See **Description of Our Capital Stock** **Restrictions on Transfer** in the accompanying prospectus for additional discussion.

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**Table of Contents**

**ADDITIONAL FEDERAL INCOME TAX CONSIDERATIONS**

This section supplements the discussion under the caption **Certain Federal Income Tax Considerations** in the accompanying prospectus, which discussion (to the extent not inconsistent with the following) is incorporated in its entirety into this prospectus supplement. The following discussion is intended to supplement, where applicable, the corresponding discussions contained in the accompanying prospectus.

This section is based on current law. The tax law upon which this discussion is based could be changed, and any such change could have a retroactive effect. The following discussion is not exhaustive of all possible tax considerations. This summary neither gives a detailed discussion of any state, local or foreign tax considerations nor discusses all of the aspects of U.S. federal income taxation that may be relevant to you in light of your particular circumstances or to particular types of stockholders of the Series C Preferred Stock which are subject to special tax rules, such as insurance companies, tax-exempt entities, financial institutions or broker-dealers, foreign corporations or partnerships, and persons who are not citizens or residents of the United States, stockholders that hold the Series C Preferred Stock as a hedge, part of a straddle, conversion transaction or other arrangement involving more than one position, or stockholders whose functional currency is not the United States dollar. This discussion assumes that you will hold the Series C Preferred Stock as a capital asset, generally property held for investment, under the Code.

We urge you to consult with your own tax advisor regarding the specific consequences to you of the acquisition, ownership and disposition of the Series C Preferred Stock, including the federal, state, local, foreign and other tax considerations of such acquisition, ownership, disposition and of our election to qualify as a REIT, as well as potential changes in applicable tax laws.

**Our Qualification as a REIT**

In connection with this offering of Series C Preferred Stock, we expect to receive the opinion of Greenberg Traurig, LLP to the effect that, commencing with our taxable year ended December 31, 1998, we have been organized and operated in conformity with the requirements for qualification and taxation as a REIT under the Code, and our method of operation will enable us to continue meet the requirements for qualification and taxation as a REIT under the Code. The opinion of Greenberg Traurig, LLP is based on various assumptions relating to our operations, including the accuracy of certain factual representations and statements made by us regarding our operations. Our qualification as a REIT depends upon our ability to meet the various requirements imposed under the Code through actual operations. Greenberg Traurig, LLP will not review our operations, and no assurance can be given that actual operations will meet these requirements. The opinion of Greenberg Traurig, LLP is not binding on the Internal Revenue Service, or any court. The opinion of Greenberg Traurig, LLP is based upon existing law, Treasury regulations and currently published administrative positions of the Internal Revenue Service and judicial decisions, all of which are subject to change either prospectively or retroactively.

Our continued qualification and taxation as a REIT depend upon our ability to meet on a continuing basis, through actual annual operating results, certain qualification tests set forth in the Code. These requirements relate to the composition of our assets, the nature of our gross income, minimum distribution requirements, and requirements relating to the ownership of our stock. A summary of certain U.S. federal income tax considerations relating to our election to be taxed as a REIT is provided in the accompanying prospectus. No assurance can be given that the actual results of our operation for any particular tax year will satisfy such requirements. For a discussion of the tax consequences of our failure to qualify as a REIT, see **Certain Federal Income Tax Considerations Failure to Qualify** in the accompanying prospectus.

**Dividends**

In general, distributions made to our stockholders out of current or accumulated earnings and profits will be treated as dividends under the Code and thus taxed to them as ordinary income, except that, as described below (see Capital Gain Dividends ), distributions of our net capital gain designated by us as capital gain dividends will be taxed to our stockholders as long-term capital gain.

S-41

## **Table of Contents**

To the extent that distributions exceed current and accumulated earnings and profits, they will constitute a return of capital, rather than dividend or capital gain income, and will reduce the basis for the stockholder's stock with respect to which the distributions are paid or, to the extent that they exceed such basis, will be taxed in the same manner as gain from the sale of that stock. For purposes of determining whether distributions are out of current or accumulated earnings and profits, our earnings and profits will be allocated first to our preferred stock and then to our common stock. Therefore, depending on our earnings and profits, distributions with respect to the Series C Preferred Stock (as compared to distributions with respect to our common stock) are more likely to be treated as dividends than as return of capital or as a distribution in excess of basis.

Dividends paid by regular C corporations to stockholders other than corporations are generally taxed at the rate applicable to long-term capital gains, which currently is a maximum of 20%, subject to certain holding period and other limitations. Because we are a REIT, however, our dividends, including dividends paid on the Series C Preferred Stock, generally will continue to be taxed at regular ordinary income tax rates, except in limited circumstances.

### **Capital Gain Dividends**

If, for any taxable year, we elect to designate as capital gain dividends any portion of the distributions paid for the year to the holders of our capital stock, the portion of the amount so designated (not in excess of our net capital gain for the year) that will be allocable to the holders of the Series C Preferred Stock will be the amount so designated multiplied by a fraction, the numerator of which will be the total dividends (within the meaning of the Code) as paid to the holders of the Series C Preferred Stock for the year, and the denominator of which will be the total dividends paid to the holders of shares of all classes of our stock for the year.

### **Conversion into Common Stock**

Except as provided in the next sentence, you will not recognize gain or loss upon the conversion of some or all of your Series C Preferred Stock into shares of our common stock. Any cash received in lieu of fractional shares, however, generally will be treated as a payment in exchange for such fractional share and you will recognize gain or loss equal to the difference between the amount of cash received and the portion of your adjusted basis allocable to the fractional share. Your tax basis in the common shares received upon conversion will equal your tax basis in your Series C Preferred Stock tendered for conversion, less the tax basis allocated to any fractional share for which cash is received. Your holding period in the common shares received upon conversion of your Series C Preferred Stock will include the holding period of the Series C Preferred Stock so converted.

### **Company Redemption Options**

If we purchase Series C Preferred Stock from you, the purchase price may be treated as a dividend (to the extent of our current and accumulated earnings and profits) unless the purchase transaction satisfies one or more of the standards set out in section 302 of the Code. Our purchase of your stock will be treated as a sale and purchase transaction (in which you would recognize taxable gain or loss to the extent that the amount paid for the redeemed shares exceeds or is less than your tax basis in such shares), and not as a dividend, if our payment to you is (i) considered to be substantially disproportionate, (ii) results in a complete termination of your interest in our stock, or (iii) is not essentially equivalent to a dividend to you within the meaning of the Code and the underlying Treasury Regulations. In determining whether any of these standards are satisfied, constructive ownership rules apply under which you may be considered to constructively own stock that is actually owned by a person related to you. The actual treatment of a payment we make to you to purchase your Series C Preferred Stock will depend upon the facts and circumstances at the time of purchase and, accordingly, you should consult your own tax advisor concerning the tax treatment of such a payment.

If our purchase of your Series C Preferred Stock is treated as a distribution that is taxable as a dividend, the amount of the distribution would be measured by the amount of cash you receive. Your adjusted tax basis in the

S-42



## **Table of Contents**

Series C Preferred Stock that we purchase would, in that case, be transferred to the remaining shares of our stock that you own. If, however, you own no remaining shares of our stock, your basis may, under certain circumstances, be transferred to a related person, or it may be lost entirely.

## **Non-United States Stockholders**

The accompanying prospectus describes certain tax consequences to a non-United States stockholder, as defined therein, that receives income, including dividends and gain on a sale or other disposition of our stock. We anticipate that the Series C Preferred Stock will be, and that our common stock will continue to be, regularly traded on an established securities market.

## **Partnerships**

If an entity treated as a partnership for U.S. federal income tax purposes holds shares of Series C Preferred Stock, the tax treatment of a partner in the partnership will generally depend upon the status of the partner and the activities of the partnership. If any prospective investor is a partner of a partnership holding shares of Series C Preferred Stock, such prospective investor should consult their tax advisor regarding the tax consequences of the ownership and disposition of the Series C Preferred Stock.

## **Medicare Tax**

Certain U.S. stockholders who are individuals, estates or trusts and whose income exceeds certain thresholds will be required to pay a 3.8% Medicare tax on dividends, interest and certain other investment income, including capital gains from the sale or other disposition of the Series C Preferred Stock. You should consult with your tax advisor regarding the possible application of this tax to you.

**Table of Contents****UNDERWRITING**

The underwriters named below are acting through their representative, MLV & Co. Subject to the terms and conditions set forth in the underwriting agreement, we have agreed to sell to the underwriters, and each underwriter has severally agreed to purchase, the number of shares of the Series C Preferred Stock set forth opposite such underwriter's name below. The underwriting agreement provides that the obligation of the underwriters to pay for and accept delivery of the Series C Preferred Stock is subject to certain conditions.

<b>Underwriters</b>	<b>Number of Shares</b>
MLV & Co. LLC	
JMP Securities LLC	
Ladenburg Thalmann & Co. Inc.	
Maxim Group LLC	
<b>Total</b>	

We have granted the underwriters an option exercisable during the 30-day period after the date of this prospectus supplement to purchase from us, at the public offering price less underwriting discounts and commissions, up to an additional \_\_\_\_\_ shares of the Series C Preferred Stock for the sole purpose of covering over-allotments, if any. To the extent that the underwriters exercise the option, each underwriter will be committed, subject to certain conditions, to purchase that number of additional shares of Series C Preferred Stock that is proportionate to such underwriter's initial commitment.

Under the terms and conditions of the underwriting agreement, the underwriters are committed to purchase all of the Series C Preferred Stock offered by this prospectus supplement, other than the shares subject to the over-allotment option, if any are purchased. We have agreed to indemnify the underwriters against certain civil liabilities under the Securities Act of 1933, as amended, or to contribute to payments the underwriters may be required to make in respect of such liabilities. We also have agreed to reimburse the underwriters for their reasonable out-of-pocket expenses in connection with this offering, including reimbursement of certain legal fees and expenses.

The underwriters initially propose to offer the Series C Preferred Stock directly to the public at the public offering price set forth on the cover page of this prospectus supplement, and to certain dealers at such offering price less a concession not to exceed \$ \_\_\_\_\_ per share. The underwriters may allow, and such dealers may reallow, a concession not to exceed \$ \_\_\_\_\_ per share to certain other dealers. If all the shares are not sold at the public offering price, the underwriters may change the public offering price and the other selling terms.

The following table provides information regarding the per share and total underwriting discounts and commissions we will pay to the underwriters. These amounts are shown assuming both no exercise and full exercise of the underwriters' option to purchase from us up to an additional \_\_\_\_\_ shares to cover over-allotments.

	<b>Per Share</b>	<b>Total</b>	
		<b>No Exercise</b>	<b>Full Exercise</b>
Public offering price	\$	\$	\$
Underwriting discounts and commissions	\$	\$	\$

Proceeds, before expenses, to us	\$	\$	\$
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The expenses of this offering, not including the underwriting discount are estimated at \$ and are payable by us.

In connection with this offering, the underwriters may purchase and sell shares of the Series C Preferred Stock in the open market. These transactions may include short sales, stabilizing transactions and purchases to

S-44

**Table of Contents**

cover positions created by short sales. Short sales involve the sale by the underwriters of a greater number of shares than they are required to purchase in this offering. Covered short sales are sales made in an amount not greater than the underwriters' option to purchase additional shares from us in this offering. The underwriters may close out any covered short position by either exercising their option to purchase additional shares or purchasing shares in the open market. In determining the source of shares to close out the covered short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option. Naked short sales are any sales in excess of such option. The underwriters must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the Series C Preferred Stock in the open market after pricing that could adversely affect investors who purchase in the public offering. Stabilizing transactions consist of various bids for or purchases of Series C Preferred Stock made by the underwriters in the open market prior to the completion of this offering.

The underwriters may also impose a penalty bid. This occurs when a particular underwriter repays to the representative a portion of the underwriting discount received by it because the representative has repurchased shares sold by or for the account of such underwriter in stabilizing or short covering transactions.

Purchases to cover a short position and stabilizing transactions may have the effect of preventing or retarding a decline in the market price of the Series C Preferred Stock and, together with the imposition of the penalty bid, may stabilize, maintain or otherwise affect the market price of the Series C Preferred Stock. As a result, the price of the Series C Preferred Stock may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued at any time.

Any of these activities may stabilize or maintain the market price of the Series C Preferred Stock above independent market levels. These transactions may be effected on the NYSE or in the over-the-counter market or otherwise. The underwriters are not required to engage in these activities and may end any of these activities at any time.

The underwriters have informed us that they do not intend to confirm sales of Series C Preferred Stock offered by this prospectus supplement to any accounts over which they exercise discretionary authority.

A prospectus supplement and accompanying prospectus in electronic format may be made available on the Internet sites of or through other online services maintained by one or more of the underwriters participating in this offering, or by their affiliates. In those cases, prospective investors may view offering terms online and, depending upon the particular underwriter, prospective investors may be allowed to place orders online. The underwriters may agree with us to allocate a specific number of shares for sale to online brokerage account holders. Any such allocation for online distributions will be made by the underwriters on the same basis as other allocations. Other than this prospectus supplement and the accompanying prospectus in electronic format, the information on any underwriter's web site and any information contained in any other web site maintained by an underwriter is not part of this prospectus supplement and the accompanying prospectus or the registration statement of which this prospectus supplement and the accompanying prospectus form a part, has not been approved and/or endorsed by us or any underwriter in its capacity as underwriter and should not be relied upon by investors.

The underwriters or their affiliates from time to time provide and may in the future provide investment banking, commercial banking and financial advisory services to us, for which they have received and may receive customary compensation.



**Table of Contents**

**LEGAL MATTERS**

Certain legal matters in connection with this offering will be passed upon for us by Greenberg Traurig, LLP. Selected legal matters related to Maryland law, including the validity of our securities offered in this prospectus supplement and accompanying prospectus, will be passed upon for us by DLA Piper LLP (US), Baltimore, Maryland. Certain legal matters relating to this offering will be passed upon for the underwriters by LeClairRyan, A Professional Corporation, New York, New York.

**EXPERTS**

The consolidated financial statements of Anworth Mortgage Asset Corporation as of December 31, 2013 and 2012 and for each of the years in the three year period ended December 31, 2013 have been incorporated by reference in this prospectus supplement and the accompanying prospectus in reliance upon the report of McGladrey LLP, independent registered public accounting firm, incorporated by reference herein and therein, and upon such reports given upon the authority of said firm as experts in auditing and accounting.

Management's report on the effectiveness of internal control over financial reporting of Anworth Mortgage Asset Corporation as of December 31, 2013 has been incorporated by reference in this prospectus supplement and the accompanying prospectus in reliance upon the report of McGladrey LLP, an independent registered public accounting firm, incorporated by reference herein and therein, and upon such reports given upon the authority of said firm as experts in auditing and accounting.

**Table of Contents**

**\$544,727,778**

**Anworth Mortgage Asset Corporation**

**Common Stock**

**Preferred Stock**

**Warrants**

By this prospectus, we may offer, from time to time:

shares of our common stock;

shares of our preferred stock;

warrants to purchase shares of our common stock or preferred stock; or

any combination of the foregoing.

We will provide the specific terms of each issuance of securities in supplements to this prospectus. You should read this prospectus and the accompanying supplement carefully before you decide to invest.

This prospectus may not be used to consummate sales of securities unless it is accompanied by a prospectus supplement.

Our common stock is traded on the New York Stock Exchange under the ticker symbol ANH, our 8.625% Series A Cumulative Preferred Stock is traded on the New York Stock Exchange under the symbol ANHPRA, and our 6.25% Series B Cumulative Convertible Preferred Stock is traded on the New York Stock Exchange under the symbol ANHPRB.

We may sell these securities to or through underwriters, dealers or agents, or we may sell the securities directly to investors on our own behalf.

**Investing in our securities involves a high degree of risk. You should carefully consider the information under the heading Risk Factors beginning on page 9 of this prospectus before buying shares of our common stock or**

**preferred stock, or warrants to purchase shares of our common stock or preferred stock.**

**Neither the U.S. Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.**

**The date of this prospectus is April 8, 2013**



**Table of Contents**

**TABLE OF CONTENTS**

	<b>Page</b>
<u>About This Prospectus</u>	1
<u>Forward-Looking Statements</u>	2
<u>Our Company</u>	3
<u>Risk Factors</u>	9
<u>Use of Proceeds</u>	31
<u>Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends</u>	31
<u>Description of our Capital Stock</u>	31
<u>Description of Warrants</u>	34
<u>Selected Provisions of Maryland Law, Our Charter and Bylaws</u>	35
<u>Certain Federal Income Tax Considerations</u>	38
<u>Plan of Distribution</u>	57
<u>Experts</u>	59
<u>Legal Matters</u>	59
<u>Information Incorporated by Reference</u>	59
<u>Where You Can Find More Information</u>	60

**Table of Contents**

**ABOUT THIS PROSPECTUS**

This prospectus is part of a registration statement filed with the U.S. Securities and Exchange Commission, or the SEC, using a shelf registration process. Under this process, we may offer and sell any combination of our common stock, preferred stock and warrants in one or more offerings for total proceeds of up to \$544,727,778. This prospectus provides you with a general description of the securities we may offer. Each time we offer to sell securities, we will provide a supplement to this prospectus that contains specific information about the terms of that offering. The prospectus supplement may also add to, update or change information contained in this prospectus. It is important that you consider the information contained in this prospectus and any prospectus supplement together with additional information described under the headings

Information Incorporated by Reference and Where You Can Find More Information, which you should read carefully before you decide to invest.

The following information is qualified in its entirety by the more detailed information and financial statements and notes thereto appearing elsewhere in, or incorporated by reference into, this prospectus. We encourage you to read this prospectus, as well as the information which is incorporated by reference herein, in their entireties.

**You should rely only on the information contained in or incorporated by reference into this prospectus. We have not authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer to sell securities in any jurisdiction where the offer or sale is not permitted. The information in this prospectus is accurate only as of the date such information is presented. Our business, financial condition, results of operations and prospects may have changed since such dates.**

**Table of Contents**

**FORWARD-LOOKING STATEMENTS**

This prospectus contains or incorporates by reference certain forward-looking statements. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. You can generally identify forward-looking statements as statements containing the words will, believe, expect, anticipate, intend, estimate, assume or other similar expressions. You should not rely on our forward-looking statements because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. Statements regarding the following subjects are forward-looking by their nature:

our business strategy;

market trends and risks;

assumptions regarding interest rates;

assumptions regarding credit risk; and

assumptions regarding prepayment rates on the mortgage loans securing our mortgage-backed securities.

These forward-looking statements are subject to various risks and uncertainties, including those relating to:

increases in the prepayment rates on the mortgage loans securing our mortgage-backed securities;

changes in the yield curve;

the availability of financing at reasonable levels and terms to support investing on a leveraged basis;

the availability of mortgage-backed securities for purchase;

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

risks associated with investing in mortgage-related assets, including changes in business conditions and the general economy, including the consequences of actions by the U.S. government and other foreign governments to address the global financial crisis;

changes in government regulations affecting our business;

our ability to maintain our qualification as a real estate investment trust for federal income tax purposes;

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

the impact of differing levels of leverage employed;

the liquidity of secondary markets and credit markets; and

management's ability to manage our growth and planned expansion.

Other risks, uncertainties and factors, including those discussed under "Risk Factors" beginning on page 9 of this prospectus or described in the reports that we file from time to time with the SEC, such as our quarterly and annual reports, could cause our actual results to differ materially and in an adverse manner from those projected in any forward-looking statements we make. We are not obligated to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## **Table of Contents**

### **OUR COMPANY**

#### **Our Business**

We are in the business of investing primarily in United States, or U.S., agency mortgage-backed securities, or Agency MBS, which are securities representing obligations guaranteed by the U.S. government, such as Ginnie Mae, or guaranteed by federally sponsored enterprises, such as Fannie Mae or Freddie Mac. Our principal business objective is to generate net income for distribution to our stockholders based upon the spread between the interest income on our mortgage assets and the costs of borrowing to finance our acquisition of those assets.

Our operations consist of the following portfolios: Agency MBS, and non-agency mortgage-backed securities, or Non-Agency MBS. Essentially our entire portfolio is comprised of Agency MBS.

We have elected to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, or the Code. As a REIT, we routinely distribute substantially all of the taxable income generated from our operations to our stockholders. As long as we retain our REIT status, we generally will not be subject to federal or state taxes on our income to the extent that we distribute our taxable net income to our stockholders. We believe we currently meet all REIT requirements regarding the ownership of our common stock and the distributions of our taxable net income. Therefore, we believe that we continue to qualify as a REIT under the provisions of the Code.

Pursuant to a Management Agreement, or the Management Agreement (a copy of which is included as Exhibit 10.1 to our Current Report on Form 8-K filed with the U.S. Securities and Exchange Commission, or the SEC, on January 3, 2012), between us and Anworth Management, LLC, or the Manager, effective as of December 31, 2011, our day-to-day operations are conducted by the Manager. The Manager is supervised and directed by our board of directors and is responsible for (i) the selection, purchase and sale of our investment portfolio; (ii) our financing and hedging activities; and (iii) providing us with management services. The Manager will also perform such other services and activities relating to our assets and operations as may be appropriate. In exchange for these services, the Manager receives a management fee paid monthly in arrears in an amount equal to one-twelfth of 1.20% of our Equity (as defined in the Management Agreement). The initial term of the Management Agreement will expire on December 31, 2013 and will automatically renew for successive one-year terms unless either party elects not to renew. If we terminate the Management Agreement, or elect not to renew without cause, then we will be required to pay a termination fee equal to three times the average annual management fee earned during the prior 24-month period.

#### **Our Strategy**

##### *Investment Strategy*

Our strategy is to invest primarily in Agency MBS. We seek to acquire assets that will produce competitive returns after considering the amount and nature of the investment's anticipated returns, our ability to pledge the investment to secure collateralized borrowings and the costs associated with financing, managing and reserving for these investments. We do not currently originate mortgage loans or provide other types of financing to the owners of real estate.

##### *Financing Strategy*

We acquire mortgage-backed securities, or MBS, by primarily using short-term borrowings and, to a lesser extent, equity capital. We employ short-term borrowing to attempt to increase potential returns to our stockholders. Pursuant to our Capital and Leverage Policy, we seek to strike a balance between the underutilization of leverage, which reduces potential returns to stockholders, and the over-utilization of leverage, which could reduce our ability to meet our obligations during adverse market conditions.

We usually borrow at short-term rates using repurchase agreements. Repurchase agreements are generally short-term in nature (less than or equal to twelve months). We actively manage the adjustment periods and the

## **Table of Contents**

selection of the interest rate indices of our borrowings against the adjustment periods and the selection of the interest rate indices on our mortgage-related assets in order to lessen the liquidity and interest rate related risks. We generally seek to diversify our exposure by entering into repurchase agreements with multiple lenders which are approved by our board of directors.

### *Growth Strategy*

It is our long-term objective to grow our earnings and our dividends per common share by increasing our paid-in capital and book value per share.

## **Our Operating Policies and Programs**

We have established the following four primary operating policies to implement our business strategies:

our Asset Acquisition Policy;

our Capital and Leverage Policy;

our Credit Risk Management Policy; and

our Asset/Liability Management Policy.

The following are summaries of these operating policies:

### *Asset Acquisition Policy*

Our Asset Acquisition Policy provides guidelines for acquiring investments and contemplates that we will acquire a portfolio of investments that can be grouped into specific categories. Each category and our respective investment guidelines are as follows:

*Category I* At least 60% of our total assets will generally be adjustable- or fixed-rate MBS and short-term investments. Assets in this category will be rated within one of the two highest rating categories by at least one nationally recognized statistical rating organization or, if not rated, will be obligations guaranteed by the U.S. government or its agencies, such as Fannie Mae or Freddie Mac. Also included in Category I are the portion of real estate mortgage loans that have been deposited into a trust and have received a rating within one of the two highest rating categories by at least one nationally recognized statistical rating organization.

*Category II* At least 90% of our total assets will generally consist of Category I investments plus unsecuritized mortgage loans, mortgage securities rated at least investment grade by at least one nationally recognized statistical rating organization, or shares of other REITs or mortgage-related companies and the portion of real estate mortgage loans that have been deposited into a trust and have received an investment grade rating by at least one nationally recognized statistical rating organization.

*Category III* No more than 10% of our total assets may be of a type not meeting any of the above criteria. Among the types of assets generally assigned to this category are mortgage securities rated below investment grade and leveraged mortgage derivative securities. Under our Category III investment criteria, we may acquire other types of mortgage derivative securities including, but not limited to, interest-only, principal-only or other types of MBS that receive a disproportionate share of interest income or principal.

### *Capital and Leverage Policy*

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We employ a leverage strategy to increase our investment assets by borrowing against existing mortgage-related assets and using the proceeds to acquire additional mortgage-related assets. Relative to our investments in investment grade Agency MBS, we generally borrow, on a short-term basis, between seven to twelve times the

## **Table of Contents**

amount of our equity allocated to these investments. During the past several years, we have borrowed, on a short-term basis, between five to eight times the amount of our equity allocated to these investments, as management believed it to be appropriate to lower our leverage due to the uncertainty in the financial marketplace and the broader problems in the economy. Our borrowings may vary from time to time depending on market conditions and other factors deemed relevant by our management and our board of directors. We believe that this will leave an adequate capital base to protect against interest rate environments in which our borrowing costs might exceed our interest income from mortgage-related assets.

Depending on the different costs of borrowing funds at different maturities, we may vary the maturities of our borrowed funds in an attempt to produce lower borrowing costs. Our borrowings are short-term and we manage actively, on an aggregate basis, both the interest rate indices and interest rate adjustment periods of our borrowings against the interest rate indices and interest rate adjustment periods on our mortgage-related assets.

Our mortgage-related assets are financed primarily at short-term borrowing rates through repurchase agreements. In the future, we may also employ borrowings under lines of credit and other collateralized financings that we may establish with approved institutional lenders.

### *Credit Risk Management Policy*

We review credit risk and other risks of loss associated with each of our potential investments. In addition, we may diversify our portfolio of mortgage-related assets to avoid undue geographic, insurer, industry and certain other types of concentrations.

Compliance with our Credit Risk Management Policy guidelines is determined at the time of purchase of mortgage-related assets based upon the most recent valuation utilized by us. Such compliance is not affected by events subsequent to such purchase including, without limitation, changes in characterization, value or rating of any specific mortgage assets or economic conditions or events generally affecting any mortgage-related assets of the type held by us.

### *Asset/Liability Management Policy*

*Interest Rate Risk Management.* To the extent consistent with our election to qualify as a REIT, we follow an interest rate risk management program intended to protect our portfolio of mortgage-related assets and related debt against the effects of major interest rate changes. Specifically, our interest rate management program is formulated with the intent to offset, to some extent, the potential adverse effects resulting from rate adjustment limitations on our mortgage-related assets and the differences between interest rate adjustment indices and interest rate adjustment periods of our adjustable-rate mortgage-related assets and related borrowings.

Our interest rate risk management program encompasses a number of procedures including the following:

monitoring and adjusting, if necessary, the interest rate sensitivity of our mortgage-related assets compared with the interest rate sensitivities of our borrowings;

attempting to structure our borrowing agreements relating to adjustable-rate mortgage-related assets to have a range of different maturities and interest rate adjustment periods (although substantially all will be less than one year); and

actively managing, on an aggregate basis, the interest rate indices and interest rate adjustment periods of our mortgage-related assets compared to the interest rate indices and adjustment periods of our borrowings.

We expect to be able to adjust the average maturity/adjustment period of our borrowings on an ongoing basis by changing the mix of maturities and interest rate adjustment periods as borrowings come due or are



## **Table of Contents**

renewed. Through the use of these procedures, we attempt to reduce the risk of differences between interest rate adjustment periods of our adjustable-rate mortgage-related assets and our related borrowings.

Depending on market conditions and the cost of the transactions, we may conduct certain hedging activities in connection with the management of our portfolio. To the extent consistent with our election to qualify as a REIT, we may adopt a hedging strategy intended to lessen the effects of interest rate changes and to enable us to earn net interest income in periods of generally rising, as well as declining or static, interest rates. Specifically, hedging programs are formulated with the intent to offset some of the potential adverse effects of changes in interest rate levels relative to the interest rates on the mortgage-related assets held in our investment portfolio and differences between the interest rate adjustment indices and periods of our mortgage-related assets and our borrowings. We monitor carefully, and may have to limit, our hedging activity to assure that we do not realize excessive hedging income or hold hedges having excess value in relation to our mortgage-related assets, which could result in our disqualification as a REIT or, in the case of excess hedging income, if the excess is due to reasonable cause and not willful neglect, the payment of a penalty tax for failure to satisfy certain REIT income tests under the Code. In addition, hedging activity involves transaction costs that increase dramatically as the period covered by hedging protection increases and that may increase during periods of fluctuating interest rates.

*Prepayment Risk Management.* We also seek to lessen the effects of prepayment of mortgage loans underlying our securities at a faster or slower rate than anticipated. We accomplish this by structuring a diversified portfolio with a variety of prepayment characteristics, investing in mortgage-related assets with prepayment prohibitions and penalties, investing in certain mortgage security structures that have prepayment protections and purchasing mortgage-related assets at a premium or at a discount. Under normal market conditions, we generally seek to maintain the aggregate capitalized purchase premium of the portfolio at 3% or less. In addition, we can purchase principal-only derivatives to a limited extent as a hedge against prepayment risks. We monitor prepayment risk through periodic review of the impact of a variety of prepayment scenarios on our revenues, net earnings, dividends, cash flow and net balance sheets market value.

We believe that we have developed cost-effective asset/liability management policies to mitigate prepayment risks. However, no strategy can completely insulate us from prepayment risks. Further, as noted above, certain of the federal income tax requirements that we must satisfy to qualify as a REIT limit our ability to fully hedge our prepayment risks. Therefore, we could be prevented from effectively hedging our prepayment risks.

## **Our Investments**

### *Mortgage-Backed Securities (MBS)*

*Pass-Through Certificates.* We principally invest in pass-through certificates, which are securities representing interests in pools of mortgage loans secured by residential real property in which payments of both interest and principal on the securities are generally made monthly, in effect, passing through monthly payments made by the individual borrowers on the mortgage loans which underlie the securities, net of fees paid to the issuer or guarantor of the securities. Early repayment of principal on some MBS, arising from prepayments of principal due to sale of the underlying property, refinancing or foreclosure, net of fees and costs which may be incurred, may expose us to a lower rate of return upon reinvestment of principal. This is generally referred to as prepayment risk. Additionally, if a security subject to prepayment has been purchased at a premium, the unamortized value of the premium would be lost in the event of prepayment.

Like other fixed-income securities, when interest rates rise, the value of a mortgage-backed security generally will decline. When interest rates are declining, however, the value of MBS with prepayment features may not increase as much as other fixed-income securities. The rate of prepayments on underlying mortgages will affect the price and volatility of MBS and may have the effect of shortening or extending the effective maturity of the security beyond what was anticipated at the time of purchase. When interest rates rise, our

## **Table of Contents**

holdings of MBS may experience reduced returns if the owners of the underlying mortgages pay off their mortgages later than anticipated. This is generally referred to as extension risk.

Payment of principal and interest on some mortgage pass-through securities, though not the market value of the securities themselves, may be guaranteed by the full faith and credit of the federal government, including securities backed by Ginnie Mae, or by agencies or instrumentalities of the federal government, including Fannie Mae and Freddie Mac. MBS created by non-governmental issuers, including commercial banks, savings and loan institutions, private mortgage insurance companies, mortgage bankers and other secondary market issuers, may be supported by various forms of insurance or guarantees including individual loan, title, pool and hazard insurance and letters of credit which may be issued by governmental entities, private insurers or the mortgage poolers. Essentially our entire portfolio is comprised of Agency MBS.

*Collateralized Mortgage Obligations.* Collateralized mortgage obligations, or CMOs, are MBS. Interest and principal on CMOs are paid, in most cases, on a monthly basis. CMOs may be collateralized by whole mortgage loans, but are more typically collateralized by portfolios of mortgage pass-through securities. CMOs are structured into multiple classes with each class bearing a different stated maturity. Monthly payments of principal, including prepayments, are first returned to investors holding the shortest maturity class; investors holding the longer maturity classes receive principal only after the first class has been retired. We will typically consider investments in CMOs that are issued or guaranteed by the federal government, or by any of its agencies or instrumentalities, to be U.S. government securities.

### *Other Types of MBS*

*Mortgage Derivative Securities.* We may acquire mortgage derivative securities in an amount not to exceed 10% of our total assets. Mortgage derivative securities provide for the holder to receive interest-only, principal-only or interest and principal in amounts that are disproportionate to those payable on the underlying mortgage loans. Payments on mortgage derivative securities are highly sensitive to the rate of prepayments on the underlying mortgage loans. In the event of faster or slower than anticipated prepayments on these mortgage loans, the rates of return on interests in mortgage derivative securities, representing the right to receive interest-only or a disproportionately large amount of interest or interest-only derivatives, would be likely to decline or increase, respectively. Conversely, the rates of return on mortgage derivative securities, representing the right to receive principal-only or a disproportionate amount of principal or principal-only derivatives, would be likely to increase or decrease in the event of faster or slower prepayments, respectively.

We may invest in inverse floaters, a class of CMOs with a coupon rate that resets in the opposite direction from the market rate of interest to which it is indexed, including LIBOR or the 11th District Cost of Funds Index, or COFI. Any rise in the index rate, which can be caused by an increase in interest rates, causes a drop in the coupon rate of an inverse floater, while any drop in the index rate causes an increase in the coupon of an inverse floater. An inverse floater may behave like a leveraged security since its interest rate usually varies by a magnitude much greater than the magnitude of the index rate of interest. The leverage-like characteristics inherent in inverse floaters result in a greater volatility of their market prices.

We may invest in other mortgage derivative securities that may be developed in the future.

*Mortgage Warehouse Participations.* We may occasionally acquire mortgage warehouse participations as an additional means of diversifying our sources of income. We anticipate that these investments, together with our investments in other Category III assets, will not, in the aggregate, exceed 10% of our total mortgage-related assets. These investments are participations in lines of credit to mortgage loan originators secured by recently originated mortgage loans that are in the process of being sold to investors. Our investments in mortgage warehouse participations are limited because they are not qualified REIT assets under the Code.

## **Table of Contents**

### *Other Mortgage-Related Assets*

We may acquire other investments that include equity and debt securities issued by other primarily mortgage-related finance companies, interests in mortgage-related collateralized bond obligations, other subordinated interests in pools of mortgage-related assets, commercial mortgage loans and securities and residential mortgage loans other than high-credit quality mortgage loans. Although we expect that our other investments will be limited to less than 10% of total assets, we have no limit on how much of our stockholders' equity will be allocated to other investments. There may be periods in which other investments represent a large portion of our stockholders' equity.

### **Competition**

When we invest in Agency MBS, we compete with a variety of institutional investors including other REITs, insurance companies, mutual funds, pension funds, investment banking firms, banks and other financial institutions that invest in the same or similar types of assets. Many of these investors have greater financial resources and access to lower costs of capital than we do.

### **Employees**

Effective December 31, 2011, in accordance with the Management Agreement, all of our employees at the Company were terminated and are now employed by the Manager.

### **General Information**

We were incorporated in Maryland on October 20, 1997 and commenced our operations on March 17, 1998. Our principal executive offices are located at 1299 Ocean Avenue, Second Floor, Santa Monica, California, 90401. Our telephone number is (310) 255-4493 and our fax number is (310) 434-0070.

## **Table of Contents**

### **RISK FACTORS**

*An investment in our securities involves a number of risks. Before making a decision to purchase our securities, you should carefully consider all of the risks described in this prospectus. If any of the risks discussed in this prospectus actually occur, our business, financial condition and results of operations could be materially affected in an adverse manner. If this were to occur, the trading price of our securities could decline significantly and you may lose all or part of your investment.*

#### **Risks Related to Our Business**

***Continued adverse developments in the global capital markets, including recent defaults, credit losses and liquidity concerns, as well as recent mergers, acquisitions and bankruptcies of potential repurchase agreement counterparties, could make it difficult for us to borrow money to acquire Agency MBS on a leveraged basis, on favorable terms or at all, which could adversely affect our profitability.***

We rely on the availability of financing to acquire Agency MBS on a leveraged basis. Institutions from which we obtain financing may have owned or financed MBS and other assets, which have declined in value and caused them to suffer losses as a result of the downturn in the residential mortgage market. As these conditions persist, institutions may be forced to exit the repurchase market, become insolvent or further tighten their lending standards or increase the amount of equity capital or haircut required to obtain financing and, in such event, could make it more difficult for us to obtain financing on favorable terms or at all.

During the past few years, there have been several proposed or completed mergers, acquisitions and bankruptcies of investment banks and commercial banks that have historically acted as repurchase agreement counterparties. This has resulted in a fewer number of potential repurchase agreement counterparties operating in the market. Fewer potential counterparties may reduce our ability to diversify and thereby attempt to minimize risk of counterparty default. In addition, many commercial banks, investment banks and insurance companies have announced extensive losses from exposure to the residential mortgage market. These losses have reduced financial industry capital, leading to reduced liquidity for some institutions, which could also make it more difficult for us to obtain financing on favorable terms or at all. Our profitability may be adversely affected if we are unable to obtain cost-effective financing for our investments.

***Failure to procure funding on favorable terms, or at all, would adversely affect our results and may, in turn, negatively affect the market price of shares of our common stock, Series A Preferred Stock or Series B Preferred Stock.***

The current weakness in the mortgage market could cause one or more of our lenders to be unwilling or unable to provide us with financing. This could potentially increase our financing costs and reduce liquidity. Furthermore, if many of our lenders are unwilling or unable to provide us with additional financing, we could be forced to sell our assets at an inopportune time when prices are depressed. If one or more major market participants fail, it could negatively impact the marketability of all fixed income securities, including Agency MBS, and this could negatively impact the value of the securities in our portfolio, thus reducing our net book value.

***If we are unable to negotiate favorable terms and conditions on future repurchase arrangements with one or more of our lenders, our financial condition and earnings could be negatively impacted.***

The terms and conditions of each repurchase arrangement with our lenders are negotiated on a transaction-by-transaction basis. Key terms and conditions of each transaction include interest rates, maturity dates, asset pricing procedures and margin requirements. We cannot assure you that we will be able to continue to negotiate favorable terms and conditions on our future repurchase arrangements.

## **Table of Contents**

Also, during periods of market illiquidity or due to perceived credit quality deterioration of the collateral pledged, a lender may require that less favorable asset pricing procedures be employed or the margin requirements be increased. Possible market developments, including a sharp rise in interest rates, a change in prepayment rates or increasing market concern about the value or liquidity of Agency MBS, may reduce the market value of our portfolio, which may cause our lenders to require additional collateral. Under these conditions, we may determine it is prudent to sell assets to improve our ability to pledge sufficient collateral to support our remaining borrowings. Such sales may be at disadvantageous times, which may harm our operating results and net profitability.

***Continued adverse developments in the residential mortgage market may adversely affect the value of the Agency MBS in which we intend to invest.***

During the past several years, the residential mortgage market in the U.S. has experienced a variety of difficulties and changing economic conditions including recent defaults, credit losses and liquidity concerns. News of actual and potential security liquidations has increased the volatility of many financial assets including Agency MBS. Further increased volatility and deterioration in the broader residential mortgage and MBS markets may adversely affect the performance and market value of the Agency MBS in which we invest.

Our investments serve 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. If market conditions result in a decline in the value of our Agency MBS, our financial position and results of operations could be adversely affected.

***New laws may be passed affecting the relationship between Fannie Mae and Freddie Mac, on the one hand, and the federal government, on the other, which could adversely affect the price of Agency MBS.***

The interest and principal payments we expect to receive on the Agency MBS in which we invest will be guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. Unlike the Ginnie Mae certificates in which we invest, the principal and interest on securities issued by Fannie Mae and Freddie Mac are not guaranteed by the U.S. government. All the Agency MBS in which we invest depend on a steady stream of payments on the mortgages underlying the securities.

Since September 2008, there have been increased market concerns about Fannie Mae's and Freddie Mac's ability to withstand future credit losses associated with securities held in their investment portfolios, and on which they provide guarantees, without the direct support of the federal government. Fannie Mae and Freddie Mac were placed into the conservatorship of the Federal Housing Finance Agency, or FHFA, their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008.

In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, the U.S. Department of the Treasury has taken various actions intended to provide Fannie Mae and Freddie Mac with additional liquidity and ensure their financial stability. The U.S. Treasury can hold its portfolio of Agency MBS to maturity and, based on mortgage market conditions, may make adjustments to the portfolio. This flexibility may adversely affect the pricing and availability for our target assets. It is also possible that if and when the U.S. Treasury commits to purchase Agency MBS in the future, it could create additional demand that would increase the pricing of Agency MBS that we seek to acquire.

Shortly after Fannie Mae and Freddie Mac were placed in federal conservatorship, the Secretary of the U.S. Treasury suggested that the guarantee payment structure of Fannie Mae and Freddie Mac should be re-examined. The future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantees could be eliminated or considerably limited relative to historical measurements. The U.S. Treasury could also

## **Table of Contents**

stop providing credit support to Fannie Mae and Freddie Mac in the future. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes an Agency MBS and could have broad adverse market implications. In addition, if Fannie Mae or Freddie Mac were eliminated, or their structures were to change radically, we would not be able to acquire Agency MBS from these companies, which would eliminate the major component of our business model.

Our income could be negatively affected in a number of ways depending on the manner in which related events unfold. For example, the current credit support provided by the U.S. Treasury to Fannie Mae and Freddie Mac, and any additional credit support it may provide in the future, could have the effect of lowering the interest rate we expect to receive from Agency MBS that we seek to acquire, thereby tightening the spread between the interest we earn on our portfolio of targeted assets and our cost of financing that portfolio. A reduction in the supply of Agency MBS could also negatively affect the pricing of Agency MBS we seek to acquire by reducing the spread between the interest we earn on our portfolio of targeted assets and our cost of financing that portfolio.

Any law affecting these government-sponsored enterprises may create market uncertainty and have the effect of reducing the actual or perceived credit quality of securities issued or guaranteed by Fannie Mae or Freddie Mac. As a result, such laws could increase the risk of loss on investments in Fannie Mae and/or Freddie Mac Agency MBS. It also is possible that such laws could adversely impact the market for such securities and spreads at which they trade. All of the foregoing could materially adversely affect our business, operations and financial condition.

***Certain actions taken or that may be taken in the future by the U.S. government to address the financial crisis could negatively affect the availability of financing, the quantity and quality of available products, cause changes in interest rates and the yield curve, any and each of which could materially adversely affect our business, results of operations and financial condition.***

The U.S. government, including the Board of Governors of the Federal Reserve System, the Department of Treasury and other governmental and regulatory bodies, have taken and are considering taking actions to address the U.S. financial crisis. During 2011 and 2012, the Federal Reserve increased its holdings of U.S. Treasury securities and, as of January 30, 2013, owned approximately \$1.7 trillion of such securities. In September 2011, the Open Market Committee of the Federal Reserve announced the launching of Operation Twist, in which the Federal Reserve would be buying approximately \$400 billion of longer-term treasury securities financed by the sale of an equal amount of the Federal Reserve's shorter-term treasury securities. These acquisitions occurred during 2012. In June 2012, the Federal Reserve announced that it extended its

Operation Twist bond swap program by buying through year-end 2012 another \$267 billion worth of securities whose maturities would range between six to thirty years and selling a similar amount of securities with durations of three years or less. Operation Twist ended on December 31, 2012. At its December 2012 meeting, the members of the Federal Reserve Board were divided on how long to continue its bond-buying program, with some wanting to continue the program through the end of 2013 and others wanting to end it well before then. A decision not to continue buying long-term Treasury securities may push long-term rates up, which could be less supportive of economic growth. On September 13, 2012, the Federal Reserve announced its intention to purchase additional Agency MBS at a pace of \$40 billion per month. These purchases will be open-ended, meaning they will continue until the Federal Reserve is satisfied that economic conditions, primarily in unemployment, improve. The Federal Reserve also announced its projection that the federal funds rate would likely remain at exceptionally low levels until at least mid-2015. In the future, the Federal Reserve may continue these actions or may take other similar actions. We cannot predict whether or when such other actions may occur or what impact, if any, such actions could have on our business, results of operations and financial condition. While such programs are intended to spur economic activity, there are no assurances that this will occur. In fact, these actions could negatively affect the availability of financing, the quantity and quality of available products, cause changes in interest rates and the yield curve, any and each of which could materially adversely affect our business, results of operations and financial condition, as well as those of the entire mortgage sector in general.

## **Table of Contents**

***A failure by the U.S. government to meet the conditions of the Budget Control Act of 2011 or to reduce its budget deficit or a further downgrade of U.S. sovereign debt and government-sponsored agency debt could have a material adverse impact on our borrowings and the valuations of our securities and may have a material adverse impact on our financial condition and results of operations.***

As widely reported, there continues to be concerns over the ability of the U.S. government to reduce its budget deficit and resolve its debt crisis. The U.S. sovereign debt and government-sponsored agency debt were downgraded from AAA to AA+ in August 2011 and continues to be on review for a downgrade of their respective credit ratings to account for the risk that U.S. lawmakers fail to meet the conditions of the Budget Control Act of 2011 and/or reduce its overall debt. Such failures could have a material adverse effect both on the U.S. economy and on the global economy. In particular, this could cause disruption in the capital markets and impact the stability of future U.S. treasury auctions and the trading market for U.S. government securities, resulting in increased interest rates and impaired access to credit. These factors could negatively impact our borrowing costs, our liquidity and the valuation of the securities we currently own in our portfolio, which could have a material adverse impact on our financial condition and our results of operations.

***The consequences of the American Taxpayer Relief Act of 2012 or a failure or delay by the U.S. government to resolve the 2013 debt ceiling could materially adversely affect our stock price, our business, results of operations and financial condition.***

On January 2, 2013, the U.S. Congress passed the American Taxpayer Relief Act of 2012, or the Taxpayer Relief Act, to avert the fiscal cliff. The Taxpayer Relief Act left current income tax rates in place for all taxpayers except for individuals making more than \$400,000 in taxable income or married couples making more than \$450,000 in taxable income, who will see their top tax rate increase from 35% to 39.6%. The long term capital gains rate was also increased from 15% to 20% for those same taxable income thresholds. The Taxpayer Relief Act also phased out the personal exemption and itemized deductions for individuals with adjusted gross income over \$250,000 and married couples with adjusted gross income over \$300,000. The employee share of the Social Security payroll tax reverted back to 6.2% from the 4.2% rate. Additionally, the Unemployment Insurance Reauthorization Act, which increased the number of weeks a person eligible to receive unemployment insurance to ninety-nine weeks, was extended for another year. The Taxpayer Relief Act also did not substantially address any major spending cuts. Additionally, the Taxpayer Relief Act did not address or resolve the U.S. government again reaching the debt ceiling, which is anticipated to occur sometime during 2013. At the end of January 2013, Congress temporarily increased the debt ceiling amount and deferred any further decision on how to resolve the debt ceiling impasse until May 19, 2013. Furthermore, the U.S. Congress passed the Health Care and Education Reconciliation Act of 2010, which expands FICA taxes to include a new 3.8% tax on certain investment income, effective for taxable years beginning after December 31, 2012, which also includes gain from the disposition of stock after 2012.

The consequences of the Taxpayer Relief Act in increasing income tax rates, payroll tax rates, and dividend and capital gains rates may materially affect our stock price. Also, delays in implementing the budget sequestration, substantially addressing spending cuts, or resolving the impending debt ceiling, could have unintended consequences on the U.S. economy and could materially affect not only our stock price but our business, results of operations and financial condition.

***Mortgage loan modification programs and future legislative action may adversely affect the value of, and the returns on, the Agency MBS in which we invest.***

The U.S. government, through the Federal Housing Authority and the Federal Deposit Insurance Corporation, has commenced implementation of programs designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures. The programs may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans or the rate of interest payable on the loans, or extending the payment terms of the loans. In addition, members of the U.S. Congress have indicated

## **Table of Contents**

support for additional legislative relief for homeowners. These loan modification programs, as well as future legislative or regulatory actions that result in the modification of outstanding mortgage loans, may adversely affect the value of, and the returns on, the Agency MBS in which we invest.

***We are subject to the risk that the global credit crisis, despite efforts by global governments to halt that crisis, may affect interest rates and the availability of financing in general, which could adversely affect our financing and our operating results.***

During the past several years, several large European banks experienced financial difficulty and were either rescued by government assistance or by other large European banks. Several European governments have coordinated plans to attempt to shore up their financial sectors through loans, credit guarantees, capital infusions, promises of continued liquidity funding and interest rate cuts. Additionally, other governments of the world's largest economic countries also implemented interest rate cuts. There is no assurance that these and other plans and programs will be successful in halting the global credit crisis or in preventing other banks from failing. If unsuccessful, this could adversely affect our financing and operations as well as those of the entire mortgage sector in general.

As the European credit crisis continues, with the bailout of Greece, and problems in other countries such as Italy and Spain, there is a growing risk to the financial condition and stability of major European banks. In the fourth quarter of 2012, France's government bond rating was lowered one grade by Moody's Investor Service. Many of the European banks have U.S. banking subsidiaries, which have provided financing to us, particularly repurchase agreement financing for the acquisition of various investments, including MBS investments. During 2011, the U.S. government placed many of the U.S. banking subsidiaries of these major European banks on credit watch. If the European credit crisis continues to impact these major European banks, there is the possibility that it will also impact the operations of their U.S. banking subsidiaries. This could adversely affect our financing and operations as well as those of the entire mortgage sector in general.

***Our leveraging strategy increases the risks of our operations.***

Relative to our investment grade Agency MBS, we generally borrow, on a short-term basis, between seven to twelve times the amount of our equity, although our borrowings may at times be above or below this amount. During the past several years, we have reduced our borrowings to a range of five to eight times the amount of our equity due to the uncertainty in the marketplace and the broader problems in the economy. We incur this leverage by borrowing against a substantial portion of the market value of our mortgage-related assets. Use of leverage can enhance our investment returns (and at times when we reduce our leverage, our profitability may be reduced as a result). Leverage, however, also increases risks. In the following ways, the use of leverage increases our risk of loss and may reduce our net income by increasing the risks associated with other risk factors including a decline in the market value of our MBS or a default of a mortgage-related asset:

The use of leverage increases our risk of loss resulting from various factors including rising interest rates, increased interest rate volatility, downturns in the economy and reductions in the availability of financing or deterioration in the conditions of any of our mortgage-related assets.

Substantially all of our borrowings are secured by our Agency MBS, generally under repurchase agreements. A decline in the market value of the Agency MBS used to secure these debt obligations could limit our ability to borrow or result in lenders requiring us to pledge additional collateral to secure our borrowings. In that situation, we could be required to sell Agency MBS under adverse market conditions in order to obtain the additional collateral required by the lender. If these sales are made at prices lower than the carrying value of the Agency MBS, we would experience losses.

A default of a mortgage-related asset that constitutes collateral for a repurchase agreement could also result in an involuntary liquidation of the mortgage-related asset. This would result in a loss to us of the difference between the value of the mortgage-related asset upon liquidation and the amount borrowed against the mortgage-related asset.



## **Table of Contents**

To the extent we are compelled to liquidate qualified REIT assets to repay debts, our compliance with the REIT rules regarding our assets and our sources of income could be affected, which could jeopardize our status as a REIT. Losing our REIT status would cause us to lose tax advantages applicable to REITs and may decrease our overall profitability and distributions to our stockholders.

***We may incur increased borrowing costs related to repurchase agreements and that would adversely affect our profitability.***

Substantially all of our borrowings are collateralized borrowings in the form of repurchase agreements. If the interest rates on these agreements increase, that would harm our profitability.

Our borrowing costs under repurchase agreements generally correspond to short-term interest rates such as LIBOR or a short-term Treasury index, plus or minus a margin. The margins on these borrowings over or under short-term interest rates may vary depending upon:

the movement of interest rates;

the availability of financing in the market; and

the value and liquidity of our mortgage-related assets.

***An increase in interest rates may harm our book value, which could adversely affect the cash available for distribution to you and could cause the price of our securities to decline.***

Increases in interest rates may harm the market value of our mortgage-related assets. Our hybrid adjustable-rate mortgage-related assets (during the fixed-rate component of the mortgages underlying such assets) and our fixed-rate securities are generally more harmed by these increases. In accordance with generally accepted accounting principles utilized in the United States of America, or GAAP, we reduce our book value by the amount of any decrease in the market value of our mortgage-related assets. Losses on securities classified as available-for-sale, which are determined by management to be other-than-temporary in nature, are reclassified from Accumulated other comprehensive income to current operations.

***An increase in interest rates may cause a decrease in the volume of newly issued, or investor demand for, MBS and other mortgage-related assets, which could adversely affect our ability to acquire MBS and other mortgage-related assets that satisfy our investment objectives and to generate income and pay dividends.***

Rising interest rates generally reduce the demand for consumer credit, including mortgage loans, due to the higher cost of borrowing. A reduction in the volume of mortgage loans originated may affect the volume of MBS and other mortgage-related assets available to us, which could affect our ability to acquire MBS and other mortgage-related assets that satisfy our investment objectives. Rising interest rates may also cause MBS and other mortgage-related assets that were issued prior to an interest rate increase to provide yields that exceed prevailing market interest rates. If rising interest rates cause us to be unable to acquire a sufficient volume of MBS or mortgage-related assets or MBS or mortgage-related assets with a yield that exceeds the borrowing cost we will incur to purchase MBS or mortgage-related assets, our ability to satisfy our investment objectives and to generate income and pay dividends in the amount expected, or at all, may be materially and adversely affected.

***A change in the LIBOR setting process could affect the interest rates that repurchase agreement counterparties charge on borrowings in general. Any such change could affect our borrowing agreements and could have an adverse impact on our net interest income.***

LIBOR is an unregulated rate based on estimates that lenders submit to the British Bankers' Association, a trade group that compiles this information and publishes daily the LIBOR rate. A settlement in the second quarter of 2012 between Barclays PLC and British and U.S. banking authorities requires Barclays PLC to base its LIBOR submissions on market prices rather than estimates of its borrowing costs. The settlement also requires an

## **Table of Contents**

independent auditor to review this process and report back to the Commodities Futures Trading Commission. In the fourth quarter of 2012, U.S. and British financial regulators fined the Swiss banking firm, UBS AG, \$1.5 billion for LIBOR manipulation. Additionally, in the first quarter of 2013, the Royal Bank of Scotland agreed to pay more than \$780 million to British and U.S. banking authorities for LIBOR manipulation. If there are other settlements with other financial institutions over the LIBOR setting process, the process may become subject to regulation and review by British and U.S. banking authorities, and the method of calculating LIBOR may change. A change in the LIBOR setting process could affect the interest rates that repurchase agreement counterparties charge on borrowings in general and could affect our borrowing agreements, which could have an adverse impact on our net interest income.

***A flat or inverted yield curve may negatively affect our operations, book value and profitability due to its potential impact on investment yields and the supply of adjustable-rate mortgage, or ARM, products.***

A flat yield curve occurs when there is little difference between short-term and long-term interest rates. An inverted yield curve occurs when short-term interest rates are higher than long-term interest rates. A flat or inverted yield curve may be an adverse environment for ARM product volume, as there may be little incentive for borrowers to choose an ARM product over a longer-term fixed-rate loan. If the supply of ARM product decreases, yields may decline due to market forces.

Our borrowing costs under repurchase agreements generally correspond to short-term interest rates such as LIBOR. A flat or inverted yield curve will likely result in lower profits.

Additionally, a flat or inverted yield curve may negatively impact the pricing of our securities. According to GAAP, if the values of our securities decrease, we reduce our book value by the amount of any decrease in the market value of our mortgage-related assets.

***We depend on short-term borrowings to purchase mortgage-related assets and reach our desired amount of leverage. If we fail to obtain or renew sufficient funding on favorable terms, we will be limited in our ability to acquire mortgage-related assets and our earnings and profitability would decline.***

We depend on short-term borrowings to fund acquisitions of mortgage-related assets and reach our desired amount of leverage. Accordingly, our ability to achieve our investment and leverage objectives depends on our ability to borrow money in sufficient amounts and on favorable terms. In addition, we must be able to renew or replace our maturing short-term borrowings on a continuous basis. Moreover, we depend on a limited number of lenders to provide the primary credit facilities for our purchases of mortgage-related assets.

If we cannot renew or replace maturing borrowings, we may have to sell our mortgage-related assets under adverse market conditions and may incur permanent capital losses as a result. Any number of these factors in combination may cause difficulties for us, including a possible liquidation of a major portion of our portfolio at disadvantageous prices with consequent losses, which may render us insolvent.

***Any repurchase agreements that we use to finance our assets may require us to provide additional collateral or pay down debt, and if these requirements are not met, our financial condition and prospects could deteriorate rapidly.***

Our repurchase agreements involve the risk that the market value of the securities pledged or sold by us to the repurchase agreement counterparty may decline in value, in which case the counterparty may require us to provide additional collateral or to repay all or a portion of the funds advanced. We may not have additional collateral or the funds available to repay our debt at that time, which would likely result in defaults unless we are able to raise the funds from alternative sources, which we may not be able to achieve on favorable terms or at all. Posting additional collateral would reduce our liquidity and limit our ability to leverage our assets. If we cannot meet these requirements, the counterparty could accelerate its indebtedness, increase the interest rate on

## **Table of Contents**

advanced funds and terminate our ability to borrow funds from them, which could materially and adversely affect our financial condition and ability to implement our investment strategy. In addition, in the event that the counterparty files for bankruptcy or becomes insolvent, our securities may become subject to bankruptcy or insolvency proceedings, thus depriving us of the benefit of these assets. In the event that we are unable to meet these collateral obligations, our financial condition and prospects could deteriorate rapidly.

***Our use of repurchase agreements to borrow funds may give our lenders greater rights in the event that either we or a lender files for bankruptcy.***

Our borrowings under repurchase agreements may qualify for special treatment under the bankruptcy code, giving our lenders the ability to avoid the automatic stay provisions of the bankruptcy code and to take possession of and liquidate our collateral under the repurchase agreements without delay in the event that we file for bankruptcy. Furthermore, the special treatment of repurchase agreements under the bankruptcy code may make it difficult for us to recover our pledged assets in the event that a lender files for bankruptcy. Thus, the use of repurchase agreements exposes our pledged assets to risk in the event of a bankruptcy filing by either a lender or us.

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

We bear the risk of being unable to dispose of our mortgage-related assets at advantageous times or in a timely manner because mortgage-related assets generally experience periods of illiquidity. The 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. As a result, the illiquidity of mortgage-related assets may cause us to lose profits and lose the ability to earn gains.

***A decrease or lack of liquidity in our investments may adversely affect our business, including our ability to value and sell our assets.***

We invest in certain MBS or other investment securities that are not publicly traded in liquid markets. Moreover, turbulent market conditions, such as those currently in effect, could significantly and negatively impact the liquidity of our assets. In some cases, it may be difficult to obtain third-party pricing on certain of our investment securities. Illiquid investments typically experience greater price volatility, as a ready market does not exist, and can be more difficult to value. In addition, third-party pricing for illiquid investments may be more subjective than for more liquid investments. The illiquidity of certain investment securities 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 certain of our investment securities. 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.

***We may not have the benefit of repurchase rights or indemnification upon the breach of broad representations and warranties for all of the assets we acquire, which could increase the risk that we suffer losses on such assets.***

We may acquire assets from counterparties that are not able or willing to provide broad representations and warranties on such assets. Even if such counterparties provide representations and warranties on the assets, they may not be contractually required to repurchase the assets or indemnify us if there are defaults with respect to the representations and warranties on the assets. To the extent that our counterparties are not contractually obligated to repurchase the assets or are unable to fulfill their indemnification obligations, we will bear the same risks with respect to such assets as if such representations and warranties were not made. If we do not have the benefit of repurchase rights or indemnification upon the breach of broad representations and warranties on our assets, we

## **Table of Contents**

may lose money on our investments in such assets that we otherwise would not lose had such repurchase rights or indemnification been available.

*Our hedging strategies may not be successful in mitigating our risks associated with interest rates.*

We engage in hedging activity from time to time. As such, we use various derivative financial instruments to provide a level of protection against interest rate risks, but no hedging strategy can protect us completely. When interest rates change, we expect to record a gain or loss on derivatives, which would be offset by an inverse change in the value of loans or residual interests. Additionally, from time to time, we may enter into hedging transactions in connection with our holdings of MBS and government securities with respect to one or more of our assets or liabilities. Our hedging activities may include entering into interest rate swaps, caps and floors, options to purchase these items and futures and forward contracts. Our actual hedging decisions will be determined in light of the facts and circumstances existing at the time and may differ from our currently anticipated hedging strategy. We cannot assure you that our use of derivatives will offset the risks related to changes in interest rates. It is likely that there will be periods in the future during which we will incur losses after accounting for our derivative financial instruments. The derivative financial instruments we select may not have the effect of reducing our interest rate risk. In addition, the nature and timing of hedging transactions may influence the effectiveness of these strategies. Poorly designed strategies or improperly executed transactions could actually increase our risk and losses. In addition, hedging strategies involve transaction and other costs. We cannot assure you that our hedging strategy and the derivatives that we use will adequately offset the risk of interest rate volatility or that our hedging transactions will not result in losses.

*The characteristics of hedging instruments presents various concerns, including illiquidity, enforceability and counterparty risks, which could adversely affect our business and results of operations.*

Hedging involves risk since hedging instruments often are not traded on regulated exchanges, guaranteed by an exchange or its clearing house, or currently regulated by any U.S. or foreign governmental authorities. Effective October 12, 2012, the Commodities Futures Trading Commission issued new rules regarding swaps under the authority granted to it pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank. These new rules will most likely not affect the terms of individual swap transactions between counterparties but will require registration and reporting through a clearing house. It is possible that we may be required to meet higher margin requirements, which could adversely affect our results of operations. Furthermore, the enforceability of such instruments may depend on compliance with applicable statutory and commodity and other regulatory requirements and, depending on the identity of the counterparty, applicable international requirements. Although registry of a swap transaction through a clearing house is intended to minimize the possibility of a loss from a default by a counterparty, such losses may still occur. The business failure of a hedging counterparty with whom we enter into a hedging transaction will most likely result in its default. Default by a party with whom we enter into a hedging transaction may result in a loss and force us to cover our commitments, if any, at the then current market price. Although generally we will 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. We cannot assure you that a liquid secondary market will exist for hedging instruments purchased or sold, and we may be required to maintain a position until exercise or expiration, which could result in losses.

*Our use of derivatives may expose us to counterparty risks.*

From time to time we enter into interest rate swap and cap agreements to hedge risks associated with movements in interest rates. If a swap counterparty cannot perform under the terms of an interest rate swap, we would not receive payments due under that agreement, we may lose any unrealized gain associated with the interest rate swap, and the hedged liability would cease to be hedged by the interest rate swap. We may also be at risk for any collateral we have pledged to secure our obligations under the interest rate swap if the counterparty

## **Table of Contents**

becomes insolvent or files for bankruptcy. Similarly, if a cap counterparty fails to perform under the terms of the cap agreement, in addition to not receiving payments due under that agreement that would offset our interest expense, we would also incur a loss for all remaining unamortized premium paid for that agreement.

***Competition may prevent us from acquiring mortgage-related assets at favorable yields and that would negatively impact our profitability.***

Our net income largely depends on our ability to acquire mortgage-related assets at favorable spreads over our borrowing costs. In acquiring mortgage-related assets, we compete with other REITs, investment banking firms, savings and loan associations, banks, insurance companies, mutual funds, other lenders and other entities that purchase mortgage-related assets, many of which have greater financial resources than us. As a result, we may not in the future be able to acquire sufficient mortgage-related assets at favorable spreads over our borrowing costs. If that occurs, our profitability will be harmed.

***Interest rate mismatches between our adjustable-rate MBS and our borrowings used to fund our purchases of these assets may reduce our income during periods of changing interest rates.***

We fund most of our acquisitions of adjustable-rate MBS (including hybrid adjustable-rate MBS) with borrowings that have interest rates based on indices and repricing terms similar to, but of shorter maturities than, the interest rate indices and repricing terms of our MBS. Accordingly, if short-term interest rates increase, this may harm our profitability.

Most of the MBS we acquire are adjustable-rate securities. This means that their interest rates may vary over time based upon changes in a short-term interest rate index. Therefore, in most cases, the interest rate indices and repricing terms of the MBS that we acquire and their funding sources will not be identical, thereby creating an interest rate mismatch between our assets and liabilities. While the historical spread between relevant short-term interest rate indices has been relatively stable, there have been periods when the spread between these indices was volatile. During periods of changing interest rates, these mismatches could reduce our net income, dividend yield and the market price of our stock.

The interest rates on our borrowings generally adjust more frequently than the interest rates on our adjustable-rate MBS. For example, at December 31, 2012, our Agency MBS and Non-Agency adjustable-rate MBS had a weighted average term to next rate adjustment of approximately 37 months, while our borrowings had a weighted average term to next rate adjustment of 34 days. After adjusting for interest rate swap transactions, the weighted average term to next rate adjustment was 420 days. Accordingly, in a period of rising interest rates, we could experience a decrease in net income or a net loss because the interest rates on our borrowings adjust faster than the interest rates on our adjustable-rate MBS.

***The MBS in which we invest and the mortgage loans underlying the MBS in which we invest are subject to delinquency, foreclosure and loss, which could result in losses to us.***

Residential mortgage loans are secured by single-family residential property and are subject to risks of loss, delinquency and foreclosure. The ability of a borrower to repay a loan secured by a residential property is dependent upon the income or assets of the borrower. A number of factors, including a general economic downturn, acts of God, terrorism, social unrest and civil disturbances, may impair borrowers' abilities to repay their loans.

Residential MBS evidence interests in or are secured by pools of residential mortgage loans and collateralized MBS evidence interests in or are secured by a single commercial mortgage loan or a pool of commercial mortgage loans. Accordingly, the MBS we invest in are subject to all of the risks of the underlying mortgage loans. In the event of defaults with respect to the mortgage loans that underlie our MBS investments and the exhaustion of any underlying or additional credit support, we may not realize our anticipated return on these investments and we may incur a loss on these investments.

## **Table of Contents**

### ***Increased levels of prepayments from MBS may decrease our net interest income.***

Pools of mortgage loans underlie the MBS that we acquire. We generally receive payments from principal payments that are made on these underlying mortgage loans. When borrowers prepay their mortgage loans faster than expected, this results in prepayments that are faster than expected on the MBS. Faster than expected prepayments could harm our profitability as follows:

We usually purchase MBS that have a higher interest rate than the market interest rate at the time. In exchange for this higher interest rate, we pay a premium over the par value to acquire the security. In accordance with accounting rules, we amortize this premium over the term of the mortgage-backed security. If the mortgage-backed security is prepaid in whole or in part prior to its maturity date, however, we expense the premium that was prepaid at the time of the prepayment. At December 31, 2012, substantially all of our MBS had been acquired at a premium.

We anticipate that a substantial portion of our adjustable-rate MBS may bear interest rates that are lower than their fully indexed rates, which are equivalent to the applicable index rate plus a margin. If an adjustable-rate mortgage-backed security is prepaid prior to or soon after the time of adjustment to a fully indexed rate, we will have held that mortgage-backed security while it was less profitable and lost the opportunity to receive interest at the fully indexed rate over the remainder of its expected life.

If we are unable to acquire new MBS similar to the prepaid MBS, our financial condition, results of operation and cash flow would suffer.

Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by conditions in the housing and financial markets, general economic conditions, actions by the federal government and the relative interest rates on fixed-rate and adjustable-rate mortgage loans.

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

### ***The timing and amount of prepayments could adversely affect our liquidity and our profitability.***

Prepayments may be difficult to predict and can vary significantly over time. As a holder of MBS, on a monthly basis, we receive a payment equal to a portion of our investment principal as the underlying mortgages are prepaid. With respect to our Agency MBS, we typically receive notice of monthly principal prepayments on the fifth business day of each month (more commonly referred to as "factor day") and receive the related scheduled payment on a specified later date, which for (i) Agency MBS guaranteed by Fannie Mae is the 25<sup>th</sup> day of that month (or the next business day thereafter); (ii) Agency MBS guaranteed by Freddie Mac is the 15<sup>th</sup> day of the following month (or the next business day thereafter); and (iii) Agency MBS guaranteed by Ginnie Mae is the 20<sup>th</sup> day of that month (or the next business day thereafter). This delay between factor day and receipt of payment creates a short-term receivable for us in the amount of any such principal prepayments. In general, on the date each month that the principal prepayments are announced (factor day), the value of our MBS pledged as collateral is reduced by the amount of the prepaid principal and, as a result, our repurchase agreement counterparties will typically initiate a margin call requiring the pledge of additional collateral or cash, in an amount equal to such prepaid principal, in order to re-establish the required ratio of borrowing to collateral value under such repurchase agreements. As the posting of such additional collateral or payment of cash to our counterparties is on or about factor day and is prior to the receipt of the payment to us by the agencies, this would reduce and, depending on the magnitude of such principal prepayments, could be material to, our liquidity. As a result, in order to meet such margin calls, we could be forced to sell assets or take other actions in order to maintain liquidity. If we were required to sell Agency MBS under adverse market conditions, we may receive sale prices lower than we might have received if we sold those securities under normal market conditions and, if

## **Table of Contents**

these prices were lower than the amortized cost of the Agency MBS, we would incur losses. An increase in prepayment rates could have a material adverse effect on our business, financial condition and results of operations.

*We may experience reduced net interest income from holding fixed-rate investments during periods of rising interest rates.*

We generally fund our acquisition of fixed-rate MBS with short-term borrowings. During periods of rising interest rates, our costs associated with borrowings used to fund acquisition of fixed-rate assets are subject to increases while the income we earn from these assets remains substantially fixed. This reduces or could eliminate the net interest spread between the fixed-rate MBS that we purchase and our borrowings used to purchase them, which could lower our net interest income or cause us to suffer a loss. At December 31, 2012, 18% of our Agency MBS were 15-year fixed-rate securities and 4% of our Agency MBS were 30-year fixed-rate securities.

*Interest rate caps on our adjustable-rate MBS may reduce our income or cause us to suffer a loss during periods of rising interest rates.*

Our adjustable-rate MBS are subject to periodic and lifetime interest rate caps. Periodic interest rate caps limit the amount an interest rate can increase during any given period. Lifetime interest rate caps limit the amount an interest rate can increase through maturity of a mortgage-backed security. Our borrowings 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 interest rate caps would limit the interest rates on our adjustable-rate MBS. This problem is magnified for our adjustable-rate MBS that are not fully indexed. Further, some adjustable-rate MBS 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 could receive less cash income on adjustable-rate MBS than we need to pay interest on our related borrowings. These factors could lower our net interest income or cause us to suffer a loss during periods of rising interest rates. At December 31, 2012, approximately 78% of our Agency MBS were adjustable-rate securities.

*We may invest in leveraged mortgage derivative securities that generally experience greater volatility in market prices, thus exposing us to greater risk with respect to their rate of return.*

We may acquire leveraged mortgage derivative securities that may expose us to a high level of interest rate risk. The characteristics of leveraged mortgage derivative securities result in greater volatility in their market prices. Thus, acquisition of leveraged mortgage derivative securities would expose us to the risk of greater price volatility in our portfolio and that could harm our net income and overall profitability.

*New assets we acquire may not generate yields as attractive or be as accretive to book value as have been experienced historically.*

We may acquire new assets as we receive principal and interest payments and prepayments from our existing assets. We also sell assets from time to time as part of our portfolio and asset/liability management programs. We may invest these proceeds into new earning assets.

New assets may not generate yields as attractive as we have experienced historically. Business conditions, including credit results, prepayment patterns and interest rate trends in the future, may not be as favorable as they have been during the periods we held the replaced assets.

New assets may not be as accretive to book value as existing assets. The market value of our assets is sensitive to interest rate fluctuations. In the past as short-term interest rates increased, the market value of our existing assets has declined. As we classify our Agency MBS and Non-Agency MBS as available-for-sale, accounting regulations require that any unrealized losses from the decline in market value that are not considered

## **Table of Contents**

to be an other-than-temporary impairment be carried as Accumulated other comprehensive loss in the Stockholders equity section of the balance sheets. When short-term interest rates stop increasing, or start declining, or when the interest rates on these securities reset, the market value of these assets may increase. This may be more accretive to book value than the new assets that we acquire to replace existing assets.

*If we are unable to find suitable investments, we may not be able to achieve our investment objectives or pay dividends.*

The availability of mortgage-related assets meeting our criteria depends upon, among other things, the level of activity and quality of and demand for securities in the mortgage securitization and secondary markets. The market for agency securities depends upon various factors including the level of activity in the residential real estate market, the level of and difference between short-term and long-term interest rates, incentives for issuers to securitize mortgage loans and demand for agency securities by institutional investors. The size and level of activity in the residential real estate lending market depends upon various factors, including the level of interest rates, regional and national economic conditions and real estate values. To the extent we are unable to acquire a sufficient volume of mortgage-related assets meeting our criteria, our results of operations would be adversely affected. Furthermore, we cannot assure you that we will be able to acquire sufficient mortgage-related assets at spreads above our costs of funds.

*We are dependent on information and communications systems and such systems failures could significantly disrupt our business.*

Our business is highly dependent on our information and communications systems. Any failure or interruption of our systems, such as caused by earthquake, fire, flood or terrorist act or by issues such as power outages, telephone or internet disconnections (notwithstanding any of our back-up systems, which could also be subject to failure), could cause delays or other problems in our securities trading activities or in our repurchase agreement transactions, which would materially adversely affect our operations and performance.

### **Risks Related to Our Management**

*We have no employees and the Manager is responsible for making all of our investment decisions. The employees of the Manager are not required to devote any specific amount of time to our business.*

Effective December 31, 2011, in accordance with the Management Agreement, we have no employees and all our prior employees became employees of the Manager. The Manager is responsible for conducting our day-to-day operations and is responsible for the selection, purchase and sale of our investment portfolio; our financing and hedging activities; providing us with management services; and such other services and activities relating to our assets and operations as may be appropriate.

Messrs. Lloyd McAdams, Joseph E. McAdams, Thad M. Brown, Ms. Bistra Pashamova and others are officers and employees of our Manager and are also officers and employees of Pacific Income Advisers, or PIA, where they devote a portion of their time. These officers and employees are under no contractual obligations mandating minimum amounts of time to be devoted to our Company. In addition, a trust controlled by Mr. Lloyd McAdams is the principal stockholder of PIA.

These officers and employees are involved in investing both our assets and approximately \$4.1 billion in MBS and other fixed income assets for institutional clients and individual investors through PIA. These multiple responsibilities and ownerships may create conflicts of interest if these officers and employees of our Company are presented with opportunities that may benefit both us and the clients of PIA. These officers allocate investments among our portfolio and the clients of PIA by determining the entity or account for which the investment is most suitable. In making this determination, these officers consider the investment strategy and



## **Table of Contents**

guidelines of each entity or account with respect to acquisition of assets, leverage, liquidity and other factors that our officers determine appropriate. These officers, however, have no obligation to make any specific investment opportunities available to us and the above-mentioned conflicts of interest may result in decisions or allocations of securities that are not in our best interests.

Additionally, there is nothing in the Management Agreement that prevents the Manager or any of its Affiliates, officers, directors or employees from engaging in other businesses or from rendering services of any kind to any other Person or entity, whether or not the investment objectives or policies of any such other Person or entity are similar to those of the Company or in any way binds or restricts the Manager or any of its Affiliates, officers, directors or employees from buying, selling or trading any securities or commodities for their own accounts or for the accounts of others for whom the Manager or any of its Affiliates, officers, directors or employees may be acting.

Mr. Lloyd McAdams is also an owner and Chairman of Syndicated Capital, Inc., a registered broker-dealer. Syndicated Capital, Inc. has been authorized by our board of directors to act as the authorized broker on any buyback of the Company's common stock. The service to PIA and Syndicated Capital, Inc. by the officers and employees of the Manager allow them to spend only part of their time and effort managing our Company, as they are required to devote a portion of their time and effort to the management of other companies, and this may harm our overall management and operating results.

***We are completely dependent upon the Manager, who provides services to us through the Management Agreement, and we may not find suitable replacements for our Manager if the Management Agreement is terminated or such key personnel are no longer available to us. The loss of any key personnel of the Manager could harm our operations.***

We no longer have any employees and are completely dependent on the Manager to conduct our operations pursuant to the Management Agreement. The Manager has its own employees, which conduct its day-to-day operations. The Management Agreement does not require the Manager to dedicate specific personnel to our operations.

If we terminate the Management Agreement without cause, we may not, without the consent of the Manager, employ any employee of the Manager or any of its Affiliates, or any Person who has been employed by the Manager or any of its Affiliates at any time within the two year period immediately preceding the date on which the Person commences employment with us for two years after such termination of the Management Agreement. We will not have retention agreements with any of our officers. We believe that the successful implementation of our investment and financing strategies will depend upon the experience of certain of the Manager's officers and employees. None of these individuals' continued service is guaranteed. If the Management Agreement is terminated or these individuals leave the Manager, the Manager may be unable to replace them with persons with appropriate experience, or at all, and we may not be able to execute our business plan.

We depend on the diligence, experience and skill of the officers and employees of the manager for the selection, structuring and monitoring of our mortgage-related assets and associated borrowings. The key officers of the Manager include Mr. Lloyd McAdams, President and Chief Executive Officer; Mr. Joseph E. McAdams, Chief Investment Officer and Executive Vice President; Mr. Thad M. Brown, Chief Financial Officer, Treasurer and Secretary; Mr. Charles J. Siegel, Senior Vice President-Finance and Assistant Secretary; Ms. Bistra Pashamova, Senior Vice President; and Mr. Evangelos Karagiannis, Vice President. Our dependence on the Manager is heightened by the fact that they have a relatively small number of employees and the loss of any key person could harm our entire business, financial condition, cash flow and results of operations. In particular, the loss of the services of Messrs. Lloyd McAdams or Joseph E. McAdams could seriously harm our business.

## **Table of Contents**

***The Management Agreement was not negotiated on an arm's-length basis and the terms, including fees payable, may not be as favorable to us as if it were negotiated with an unaffiliated third party.***

Effective as of December 31, 2011, we entered into the Management Agreement, which effected the externalization of our management function. The Management Agreement was negotiated between related parties, and we did not have the benefit of arm's-length negotiations of the type normally conducted with an unaffiliated third party. The terms of the Management Agreement, including fees payable, may not reflect the terms we may have received if it was negotiated with an unrelated third party. In addition, as a result of this relationship, we may choose not to enforce, or to enforce less vigorously, our rights under the Management Agreement because of our desire to maintain our ongoing relationship with our Manager.

***If we elect to not renew the Management Agreement without cause, we would be required to pay the Manager a substantial termination fee. These and other provisions in the Management Agreement make non-renewal of the Management Agreement difficult and costly.***

Electing not to renew the Management Agreement without cause would be difficult and costly for us. With the consent of the majority of our independent directors, we may elect not to renew our Management Agreement after the initial term of the Management Agreement, which will expire on December 31, 2013, or upon the expiration of any automatic renewal term, both upon 180-days prior written notice. In addition, if we elect to not renew the Management Agreement because of a decision by our board that the management fee is unfair, the Manager has the right to renegotiate a mutually agreeable management fee. If we elect to not renew the Management Agreement without cause, we are required to 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 most recently completed month prior to the effective date of termination. These provisions may increase the effective cost to us of electing to not renew the Management Agreement.

***The management fee is payable regardless of our performance.***

The Manager is entitled to receive a management fee from us that is based on 1.20% of our Equity (as defined in our Management Agreement), regardless of the performance of our investment portfolio. For example, we would pay our Manager a management fee for a specific period even if we experienced a net loss during the same period. The Manager's entitlement to substantial nonperformance-based compensation may reduce its incentive to devote sufficient time and effort to seeking investments that provide attractive risk-adjusted returns for our investment portfolio. This in turn could harm our ability to make distributions to our stockholders and the market price of our common stock.

***The fee structure of the Management Agreement may limit the Manager's ability to retain access to its key personnel.***

Under the terms of the Management Agreement, we are required to pay the Manager a base management fee payable monthly in arrears in an amount equal to one twelfth of 1.20% of our Equity. Our Equity is defined as our month-end stockholders' equity, adjusted to exclude the effect of any unrealized gains or losses included in either retained earnings or other comprehensive income, each as computed in accordance with GAAP. The Management Agreement does not provide the Manager with an incentive management fee that would pay the Manager additional compensation as a result of meeting performance targets. Some of our externally-managed competitors pay their managers an incentive management fee, which enables them to provide additional compensation to their key personnel. Thus, the lack of an incentive fee in the Management Agreement may limit the ability of the Manager to provide key personnel with additional compensation for strong performance, which could adversely affect the Manager's ability to retain these key personnel. If the Manager were not able to retain any of the key personnel providing services to the Manager, it would have to find replacement personnel to provide those services. Those replacement key personnel may not be able to produce the same operating results as the current key personnel.

## **Table of Contents**

***Some investors may not view our external management in a positive light, which may affect the market price of our common stock and may make it more difficult for future offerings of our stock.***

Although there are currently other mortgage REITs that are externally-managed, there may be times in the future when some investors may have a preference for internally-managed companies. There may also be times, if there are low returns from our portfolio, when our external management is not viewed in a positive light. In either of these cases, there may be a negative effect on the market price of our common stock and this may make it difficult for future offerings of our common stock.

***Potential conflicts of interest could arise if the Manager were to take greater risk for the purpose of increasing our equity in order to earn a greater management fee.***

The Management Agreement does not contain an incentive fee. The Manager is paid a base management fee payable monthly in arrears in an amount equal to one twelfth of 1.20% of our Equity, as defined in the Management Agreement. As the Management Agreement does not contain an incentive fee, the Manager may take greater risk in our investment portfolio to increase our equity in order to earn a greater management fee.

***Our Manager's liability is limited under the Management Agreement, and we have agreed to indemnify our Manager against certain liabilities.***

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 any advice or recommendation of the Manager. The Manager and its Affiliates, and the directors, officers, employees and stockholders of the Manager and its Affiliates, are not liable to us, any subsidiary of ours, our board of directors or our stockholders for any acts or omissions by the Manager, its officers, employees or its Affiliates, performed in accordance with and pursuant to our Management Agreement, except by reason of acts constituting bad faith, willful misconduct, gross negligence or reckless disregard of their respective duties under this Management Agreement. We have agreed to indemnify our Manager and its Affiliates, its directors, officers, employees and stockholders of the Manager and its Affiliates (each a Manager Indemnified Party) of and from any and all expenses, losses, damages, liabilities, demands, charges and claims of any nature whatsoever (including reasonable attorneys fees) in respect of or arising from any acts or omissions of such Manager Indemnified Party, not constituting bad faith, willful misconduct, gross negligence or reckless disregard of duties of such Manager Indemnified Party under this Management Agreement.

***Our Manager has limited resources and may not be able to defend itself in litigation.***

The only fee that our Manager receives from us is the base management fee, as previously described. It is anticipated that most, if not all, of this fee will be used by the Manager for compensation to its employees and to pay for its other administrative expenses. Our Manager has limited resources. If our Manager were to be involved in litigation not related to our operations, it may not be able to defend itself and it may be forced to declare bankruptcy or go out of business and we would have to find another Manager. This could have a material adverse impact on our business and our operations.

***Failure of our Manager to comply with SEC rules and regulations could cause various disciplinary actions which could cause a disruption in services provided to us and may impact our business operations and our profitability.***

Under recent rules promulgated under Dodd-Frank, the Manager is considered an investment adviser. In reliance upon the no-action letter issued by the SEC to the American Bar Association on January 18, 2012, we consider Anworth Management, LLC to be a relying adviser, which means that its registration as an investment adviser is integrated into the existing registration of PIA, its filing adviser. Anworth Management, LLC and PIA are both subject to the Investment Advisers Act of 1940 and the rules and regulations of the SEC and also

## **Table of Contents**

are subject to examination by the SEC. Any failure by Anworth Management, LLC, PIA, or any of their respective employees to comply with such rules and regulations could cause various disciplinary actions, up to and including loss of registration status as investment advisers. Such disciplinary actions could lead to disruptions in the services provided to us which may impact our business operations and our profitability.

***Our board of directors may change our operating policies and strategies without prior notice or stockholder approval and such changes could harm our business, results of operation and stock price.***

Our board of directors can modify or waive our current operating policies and our strategies without prior notice and without stockholder approval. We cannot predict the effect any changes to our current operating policies and strategies may have on our business, operating results and stock price, however, the effects may be adverse.

### **Risks Related to REIT Compliance and Other Tax Matters**

***If we are disqualified as a REIT, we will be subject to tax as a regular corporation and face substantial tax liability.***

We believe that, since our initial public offering in 1998, we have operated so as to qualify as a REIT under the Code and we intend to continue to meet the requirements for taxation as a REIT. Nevertheless, we may not remain qualified as a REIT in the future. Qualification as a REIT involves the application of highly technical and complex Code provisions for which only a limited number of judicial or administrative interpretations exist. Even a technical or inadvertent mistake could require us to pay a penalty or jeopardize our REIT status. Furthermore, Congress or the Internal Revenue Service, or the IRS, might change tax laws or regulations and the courts might issue new rulings, in each case potentially having retroactive effects that could make it more difficult or impossible for us to qualify as a REIT. If we fail to qualify as a REIT in any tax year, then:

we would be taxed as a regular domestic corporation, which, among other things, means being unable to deduct distributions to stockholders in computing taxable income and being subject to federal income tax on our taxable income at regular corporate rates;

any resulting tax liability could be substantial and would reduce the amount of cash available for distribution to stockholders;

we would no longer be required to make distributions to our stockholders; and

unless we were entitled to relief under applicable statutory provisions, we could be disqualified from treatment as a REIT for the subsequent four taxable years following the year during which we lost our qualification and thus our cash available for distribution to stockholders would be reduced for each of the years during which we do not qualify as a REIT.

***Complying with REIT requirements may cause us to forego otherwise attractive opportunities.***

In order to qualify as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, our sources of income, the nature and diversification of our MBS and other assets, the amounts we distribute to our stockholders and the ownership of our stock. We may also be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution. Thus, compliance with REIT requirements may hinder our ability to operate solely on the basis of maximizing profits.

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

Compliance with the REIT provisions of the Code may limit our ability to hedge our assets and operations. Under these provisions, any income that is generated from transactions intended to hedge our interest rate,

## **Table of Contents**

inflation and/or currency risks will be excluded from gross income for purposes of the REIT 75% and 95% gross income tests if the instrument hedges (1) interest rate risk on liabilities incurred to carry or acquire real estate or (2) risk of currency fluctuations with respect to any item of income or gain that would be qualifying income under the REIT 75% or 95% gross income tests, and such instrument is properly identified under applicable Treasury Regulations. Income from hedging transactions that does not meet these requirements will generally constitute non-qualifying income for purposes of both the REIT 75% and 95% gross income tests. As a result of these rules, we may have to limit its use of hedging techniques that might otherwise be advantageous, which could result in greater risks associated with interest rate or other changes than we would otherwise incur.

***Complying with REIT requirements may force us to liquidate otherwise attractive investments or to make investments inconsistent with our business plan.***

In order to qualify as a REIT, we must also determine 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 REIT real estate assets. The remainder of our investment in securities 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 assets can consist of the securities of any one issuer. No more than 25% of the total value of our assets can be stock in taxable REIT subsidiaries. If we fail to comply with these requirements, we must dispose of a portion of our assets within 30 days after the end of the calendar quarter in order to avoid losing our REIT status and suffering adverse tax consequences. The need to comply with these gross income and asset tests may cause us to acquire other assets that are qualifying real estate assets for purposes of the REIT requirements that are not part of our overall business strategy and might not otherwise be the best investment alternative for us.

***Complying with REIT requirements may force us to borrow to make distributions to stockholders.***

As a REIT, we must distribute 90% of our annual taxable income (subject to certain adjustments) to our stockholders. At the time when we are required to make previously declared dividend distributions, declines in the value of our portfolio holdings and the resulting subsequent margins calls may have depleted most or all of our cash and cash equivalents. If this were to occur and if market conditions allowed us to do so, we would sell some of our portfolio holdings to generate sufficient funds to make the dividend payments. If market conditions did not allow us to sell portfolio holdings, we would be required to borrow funds on an unsecured basis to make the previously declared dividend payments.

***Dividends payable by REITs do not qualify for the reduced tax rates.***

Tax legislation enacted in 2003 and extended in 2010 to be effective through December 31, 2012, temporarily reduced the maximum U.S. federal tax rate on certain corporate dividends ( Qualified Dividends ) paid to individuals and other non-corporate taxpayers to 15%. In January 2013, the Taxpayer Relief Act permanently extended these rates except for individuals with taxable income over \$400,000 and married couples with taxable income over \$450,000. For those taxpayers, the tax rate on Qualified Dividends was increased to 20%. Dividends paid by REITs to these stockholders generally do not constitute Qualified Dividends and, as such, are generally not eligible for these reduced rates. Although this legislation does not adversely affect the taxation of REITs or dividends paid by REITs, the more favorable rates applicable to non-REIT corporate 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.

## **Table of Contents**

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

A REIT's net income from prohibited transactions is subject to a 100% tax. In general, prohibited transactions are sales or other dispositions of property, other than foreclosure property but including any mortgage loans, held in inventory primarily for sale to customers in the ordinary course of business. We might be subject to this tax if we were to sell a loan or securitize loans in a manner that was treated as a sale of such inventory for federal income tax purposes. Therefore, in order to avoid the prohibited transactions tax, we may choose not to engage in certain sales of loans other than through a taxable REIT subsidiary and may limit the structures we utilize for our securitization transactions even though such sales or structures might otherwise be beneficial for us. In addition, this prohibition may limit our ability to restructure our investment portfolio of mortgage loans from time to time, even if we believe that it would be in our best interest to do so.

***We may incur excess inclusion income that would increase the tax liability of our stockholders.***

In general, dividend income that a tax-exempt entity receives from us should not constitute unrelated business taxable income as defined in Section 512 of the Code. If we realize excess inclusion income and allocate it to stockholders, however, then this income would be fully taxable as unrelated business taxable income under Section 512 of the Code. If the stockholder is foreign, it would generally be subject to U.S. federal income tax withholding on this income without reduction pursuant to any otherwise applicable income tax treaty. U.S. stockholders would not be able to offset such income with their operating losses.

We generally structure our borrowing arrangements in a manner designed to avoid generating significant amounts of excess inclusion income. However, excess inclusion income could result if we held a residual interest in a REMIC. Excess inclusion income also may be generated if we were to issue debt obligations with two or more maturities and the terms of the payments on these obligations bore a relationship to the payments that we received on our mortgage loans or MBS securing those debt obligations. For example, we may engage in non-REMIC CMO securitizations. We also enter into various repurchase agreements that have differing maturity dates and afford the lender the right to sell any pledged mortgage securities if we default on our obligations. The IRS may determine that these transactions give rise to excess inclusion income that should be allocated among our stockholders. We may invest in equity securities of other REITs and it is possible that we might receive excess inclusion income from those investments. Some types of entities, including, without limitation, voluntarily employee benefit associations and entities that have borrowed funds to acquire their shares of our stock, may be required to treat a portion of or all of the dividends they receive from us as unrelated business taxable income.

***Misplaced reliance on legal opinions or statements by issuers of MBS and government securities could result in a failure to comply with REIT gross income or asset tests.***

When purchasing MBS and government securities, we may rely on opinions of counsel for the issuer or sponsor of such securities, or statements made in related offering documents, for purposes of determining whether and to what extent those securities constitute real estate assets for purposes of the REIT asset tests and produce income that qualifies under the REIT income tests. The inaccuracy of any such opinions or statements may harm our REIT qualification and result in significant corporate level tax.

## **Table of Contents**

### **Additional Risk Factors**

#### ***Failure to maintain an exemption from the Investment Company Act would materially harm our results of operations.***

We believe that we conduct our business in a manner that results in our not being regulated as an investment company under the Investment Company Act of 1940, as amended, or the Investment Company Act. If we fail to continue to qualify for an exemption from registration as an investment company, our ability to use leverage would be substantially reduced and we would be unable to conduct our business as we presently do. The Investment Company Act has an exemption for entities that are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. Under the SEC's current interpretation, we qualify for this exemption if we maintain at least 55% of our assets directly in qualifying real estate interests. In meeting the 55% requirement under the Investment Company Act, we treat MBS issued with respect to an underlying pool for which we hold all issued certificates as qualifying interests. If the SEC or its staff adopts a contrary interpretation, we could be required to sell a substantial amount of our MBS under potentially adverse market conditions. Further, in order to maintain our exemption from registration as an investment company by acquiring mortgages and other liens on and interests in real estate, we may be precluded from acquiring MBS whose yield is somewhat higher than the yield on mortgages and other liens on and interests in real estate that could be purchased in a manner consistent with the exemption.

On August 31, 2011, the SEC issued a release soliciting comments on the mortgage REIT exemption under the Investment Company Act. The SEC indicated in its release that it is concerned that some mortgage companies may be subject to the kinds of abuses that the Investment Company Act was intended to address, such as misvaluations of a company's investment portfolio and excessive leveraging. The release asked for comments on or before November 7, 2011 on whether the exclusion should be narrowed or changed in such a way that these potential abuses can be curtailed. The SEC also asked whether there are existing safeguards in the structure and operations of REITs and other mortgage companies that would address these or similar concerns. Although we believe that we have conducted our operations in a manner that would not be of the types of concerns addressed in the SEC's release, we could be subject to any rules or regulations that the SEC could propose in changing or narrowing the current exclusion that mortgage REITs rely on to maintain an exemption from the Investment Company Act. If the SEC or its staff changes or narrows this exemption, we could be required to sell a substantial amount of our MBS under potentially adverse market conditions. Although, at the present time, it is unknown whether the SEC or its staff will make any changes to this exclusion or the nature of any such changes, it is possible that any such changes could impact our Asset Acquisition Policy, our leverage, our liquidity, the size of our investment portfolio, our ability to use interest rate swap agreements, our ability to borrow, and could have a material adverse effect on our business and results of operations.

***We presently are not, nor do we intend to be, regulated as an investment company. Fluctuations in our net income and in our book value will likely be greater than those of investment companies. This may affect investors or potential investors as to the appropriateness of our stock as compared to that of an investment company.***

While presently our assets are similar to those owned by some investment companies, we are not regulated as an investment company. Regulation as an investment company entails all investment companies maintaining significantly lower levels of financial leverage than we have employed since our organization in 1998. Because of the differences in our leverage from that of investment companies, this results in the fluctuation in net income and in book value by us to likely be greater than that experienced by investment companies. Therefore, investors and potential investors in our company should, on an ongoing basis, carefully determine if this greater level of income fluctuation and book value fluctuation is appropriate for them as compared to whether the less volatile results of investment companies are more appropriate for them.

## **Table of Contents**

### ***The market price of our common stock may fluctuate significantly.***

The market price and marketability of shares of our securities may, from time to time, be significantly affected by numerous factors, including many over which we have no control and that may not be directly related to us. These factors including the following:

price and volume fluctuations in the stock market from time to time, which are often unrelated to the operating performance of particular companies;

significant volatility in the market price and trading volume of securities of REITs or other companies in our sector, which is not necessarily related to the operating performance of these securities;

changes in regulatory policies, tax guidelines and financial accounting and reporting standards, particularly with respect to REITs;

changes in business conditions and the general economy, including the consequences of actions by the U.S. government and other foreign governments to address the global financial crisis;

changes in our dividend policy and earnings or variations in operating results;

any shortfall in revenue or net income or any increase in losses from levels expected by securities analysts;

general economic trends and other external factors; and

loss of major repurchase agreement providers.

Fluctuations in the trading price of our common stock may adversely affect the liquidity of the trading market for our common stock and, in the event that we seek to raise capital through future equity financings, our ability to raise such equity capital.

### ***We may not be able to use the money we raise from time to time to acquire investments at favorable prices.***

We intend to seek to raise additional capital from time to time if we determine that it is in our best interests and the best interests of our stockholders, including through public offerings of our stock. The net proceeds of any offering could represent a significant increase in our equity. Depending on the amount of leverage that we use, the full investment of the net proceeds of any offering might result in a substantial increase in our total assets. There can be no assurance that we will be able to invest all of such additional funds in mortgage-related assets at favorable prices. We may not be able to acquire enough mortgage-related assets to become fully invested after an offering, or we may have to pay more for MBS than we have historically. In either case, the return that we earn on stockholders' equity may be reduced.

### ***We have not established a minimum dividend payment level for our common stockholders and there are no assurances of our ability to pay dividends to them in the future.***

We intend to pay quarterly dividends and to make distributions to our common stockholders in amounts such that all or substantially all of our taxable income in each year, subject to certain adjustments, is distributed. This, along with other factors, should enable us to qualify for the tax benefits accorded to a REIT under the Code. We have not established a minimum dividend payment level for our common stockholders and our ability to pay dividends may be harmed by the risk factors described in this prospectus. All distributions to our common stockholders will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our board of directors may deem relevant from time to time. There are no assurances of our ability to pay dividends in the future.



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If we raise additional capital, our earnings per share and dividends per share may decline since we may not be able to invest all of the new capital during the quarter in which additional shares are sold and possibly the entire following calendar quarter.

## **Table of Contents**

***Our charter does not permit ownership of over 9.8% of our common or preferred stock and attempts to acquire our common or preferred stock in excess of the 9.8% limit are void without prior approval from our board of directors.***

For the purpose of preserving our REIT qualification and for other reasons, our charter prohibits direct or constructive ownership by any person of more than 9.8% of the lesser of the total number or value of the outstanding shares of our common stock or more than 9.8% of the outstanding shares of our preferred stock. Our charter's constructive ownership rules are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than 9.8% of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of 9.8% of the outstanding stock and thus be subject to our charter's ownership limit. Any attempt to own or transfer shares of our common or preferred stock in excess of the ownership limit without the consent of the board of directors shall be void and will result in the shares being transferred by operation of law to a charitable trust. Our board of directors has granted one third party institutional investor an exemption from the 9.8% ownership limitation as set forth in our charter documents. This exemption permitted the third party institutional investor to hold up to 20.0% of our Series A Preferred Stock.

***Because provisions contained in Maryland law, our charter and our bylaws may have an anti-takeover effect, investors may be prevented from receiving a control premium for their shares.***

Provisions contained in our charter and bylaws, as well as Maryland corporate law, may have anti-takeover effects that delay, defer or prevent a takeover attempt, which may prevent stockholders from receiving a control premium for their shares. For example, these provisions may defer or prevent tender offers for our common stock or purchases of large blocks of our common stock, thereby limiting the opportunities for our stockholders to receive a premium for their common stock over then-prevailing market prices. These provisions include the following:

*Ownership limit.* The ownership limit in our charter limits related investors including, among other things, any voting group, from acquiring over 9.8% of our common stock or more than 9.8% of our preferred stock without our permission.

*Preferred Stock.* Our charter authorizes our board of directors to issue preferred stock in one or more classes and to establish the preferences and rights of any class of preferred stock issued. These actions can be taken without soliciting stockholder approval.

*Maryland business combination statute.* Maryland law restricts the ability of holders of more than 10% of the voting power of a corporation's shares to engage in a business combination with the corporation.

*Maryland control share acquisition statute.* Maryland law limits the voting rights of control shares of a corporation in the event of a control share acquisition.

***Future offerings of debt securities, which would be senior to our common stock, Series A Preferred Stock and Series B Preferred Stock upon liquidation, or other equity securities, which would dilute our existing stockholders and may be senior to our common stock, Series A Preferred Stock and Series B Preferred Stock for the purposes of dividend distributions, may harm the market price of our common stock, Series A Preferred Stock or Series B Preferred Stock.***

In the future, we may attempt to increase our capital resources by making additional offerings of debt or equity securities, including commercial paper, medium-term notes, senior or subordinated notes and classes of preferred stock or common stock. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common stock. Our preferred stock may have a preference on dividend payments that could limit our ability to make a dividend distribution to the holders of our common stock. Because our decision to issue

## **Table of Contents**

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, our common stockholders bear the risk of our future offerings reducing the market price of our common stock.

Our charter provides that we may issue up to 20 million shares of preferred stock in one or more series. The issuance of additional preferred stock on parity with or senior to the Series A Preferred Stock or Series B Preferred Stock could have the effect of diluting the amounts we may have available for distribution to holders of the Series A Preferred Stock or Series B Preferred Stock. The Series A Preferred Stock and Series B Preferred Stock will be subordinated to all our existing and future debt. Thus, our Series A Preferred Stockholders and our Series B Preferred Stockholders bear the risk of our future offerings reducing the market price of our Series A Preferred Stock or Series B Preferred Stock.

We may issue additional shares of common stock or shares of preferred stock that are convertible into common stock. If we issue a significant number of shares of common stock or convertible preferred stock in a short period of time, there could be a dilution of the existing common stock and a decrease in the market price of the common stock.

## **USE OF PROCEEDS**

Unless otherwise indicated in an accompanying prospectus supplement, we intend to use the net proceeds from the sale of the securities offered by this prospectus and the related accompanying prospectus supplement to acquire Agency MBS consistent with our investment policy. We then intend to increase our investment assets by borrowing against these Agency MBS and using the proceeds of such borrowings to acquire additional Agency MBS. Pending such investments, we will place the net proceeds in interest-bearing bank accounts or in readily marketable, interest-bearing securities.

## **RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED STOCK DIVIDENDS**

The following table sets forth our ratios of earnings to combined fixed charges and preferred stock dividends for the periods shown:

	For the Year Ended December 31,				
	2012	2011	2010	2009	2008
Ratio	2.09	2.29	2.09	2.07	1.29

The ratios of earnings to combined fixed charges and preferred stock dividends were computed by dividing earnings as adjusted by combined fixed charges and preferred stock dividends. For this purpose, earnings consist of net income from continuing operations and fixed charges. Fixed charges consist of interest expense on all indebtedness and preferred stock dividends paid on our outstanding shares of Series A Cumulative Preferred Stock.

## **DESCRIPTION OF OUR CAPITAL STOCK**

The description of our capital stock set forth below does not purport to be complete and is qualified in its entirety by reference to our charter and our bylaws, copies of which are exhibits to the registration statement of which this prospectus is a part.

## **Table of Contents**

### **General**

Our authorized capital stock consists of 200 million shares of common stock, \$0.01 par value per share, of which 144,184,693 are issued and outstanding as of April 4, 2013, and 20 million shares of preferred stock, \$0.01 par value per share, issuable in one or more series. As of April 4, 2013, our board of directors had classified 5,150,000 shares of preferred stock as Series A Cumulative Preferred Stock, referred to as our Series A Preferred Stock, of which 1,919,378 are issued and outstanding, and classified 3,150,000 shares of preferred stock as Series B Cumulative Convertible Preferred Stock, referred to as our Series B Preferred Stock, of which 1,053,640 are issued and outstanding.

### **Common Stock**

All shares of common stock offered hereby will be duly authorized, fully paid and nonassessable. The statements below describing the common stock are in all respects subject to and qualified in their entirety by reference to the Maryland General Corporation Law, our charter, any articles supplementary to our charter, and bylaws.

#### *Voting*

Each of our common stockholders is entitled to one vote for each share of common stock held of record on each matter submitted to a vote of common stockholders. Meetings of our stockholders are to be held annually and special meetings may be called by a majority of our board of directors, the chairman of our board of directors or our president. Special meetings shall be called by our secretary at the written request of our stockholders entitled to cast at least a majority of all the votes entitled to be cast at a meeting.

#### *Dividends; Liquidation; Other Rights*

Common stockholders are entitled to receive dividends when, as and if declared by our board of directors out of legally available funds. The right of our common stockholders to receive dividends is subordinate to the rights of our preferred stockholders. If we liquidate, dissolve or wind up, whether voluntary or involuntary, our common stockholders will share ratably in all of our assets remaining after the payment of all of our liabilities and the payment of all liquidation and other preference amounts to our preferred stockholders. Common stockholders have no preemptive or other subscription rights, and there are no conversion or exchange rights, or redemption or sinking fund provisions, relating to the shares of common stock.

#### *Classification or Reclassification of Common Stock or Preferred Stock*

Our charter authorizes our board of directors to classify or reclassify any unissued shares of capital stock into other classes or series of shares, to establish the number of shares in each class or series and to set the preferences, conversion and other rights, voting powers, restrictions, limitations, restrictions on ownership, limitations as to dividends, qualifications and terms or conditions of redemption for each class or series.

#### *Transfer Agent and Registrar*

Our transfer agent and registrar is American Stock Transfer & Trust Company.

### **Preferred Stock**

All shares of preferred stock, if and when issued, will be validly issued, fully paid, and non-assessable. Because our board of directors has the power to establish the preferences, powers and rights of each series of preferred stock, our board of directors may afford the holders of any series of preferred stock preferences, powers and rights, voting or otherwise, senior to the rights of common stockholders.

## **Table of Contents**

The rights, preferences, privileges and restrictions of each series of preferred stock will be fixed by the articles supplementary relating to such series. A prospectus supplement relating to each series will specify the terms of the preferred stock, including, where applicable, the following: (i) the title and stated value of the preferred stock; (ii) the voting rights of the preferred stock, if applicable; (iii) the preemptive rights of the preferred stock, if applicable; (iv) the restrictions on transfer of the preferred stock, if applicable; (v) the number of shares offered, the liquidation preference per share and the offering price of the shares; (vi) the dividend rate(s), period(s) and payment date(s) or method(s) of calculation applicable to the preferred stock, including the date from which dividends on the preferred stock will accumulate, if applicable; (vii) the provision for a sinking fund, if any, for the preferred stock; (viii) the provision for and any restriction on redemption, if applicable, of the preferred stock; (ix) the provision for and any restriction on repurchase, if applicable, of the preferred stock; (x) the terms and provisions, if any, upon which the preferred stock will be convertible into common stock, including the conversion price (or manner of calculation) and conversion period; (xi) the relative ranking and preferences of the preferred stock as to dividend rights and rights upon the liquidation, dissolution or winding-up of our affairs; and (xii) any limitation on issuance of any series of preferred stock ranking senior to or on a parity with the series of preferred stock as to dividend rights and rights upon the liquidation, dissolution or winding-up of our affairs.

### **Restrictions on Transfer**

Two of the requirements of qualification for the tax benefits accorded by the REIT provisions of the tax code are that (1) during the last half of each taxable year not more than 50% in value of the outstanding shares may be owned directly or indirectly by five or fewer individuals, and (2) there must be at least 100 stockholders on 335 days of each taxable year of 12 months.

In order that we may meet these requirements at all times, our charter prohibits any person from owning, acquiring or holding, directly or indirectly, without prior approval by our board of directors, shares of any class of our capital stock in excess of 9.8% in value of the aggregate of the outstanding shares of capital stock or shares of our common stock in excess of 9.8% (in value or in number of shares, whichever is more restrictive) of the aggregate of the outstanding shares of our common stock. For this purpose, ownership includes both beneficial ownership and constructive ownership. Beneficial ownership is defined in our charter to include interests that would be treated as owned through the application of Section 544 of the tax code, as modified by Section 856(h)(1)(B) of the tax code. Constructive ownership is defined in our charter to include interests that would be treated as owned through the application of Section 318(a) of the tax code, as modified by Section 856(d)(5) of the tax code. Subject to certain limitations, our board of directors may increase or decrease the ownership limitations or waive the limitations for individual investors.

For purposes of the 50% stockholder test discussed above, the constructive ownership provisions applicable under Section 544 of the tax code attribute ownership of securities owned by a corporation, partnership, estate or trust proportionately to its stockholders, partners or beneficiaries, attribute ownership of securities owned by family members to other members of the same family, treat securities with respect to which a person has an option to purchase as actually owned by that person, and set forth rules for application of such attribution provisions (e.g., reattribution of stock that is constructively owned). Thus, for purposes of determining whether a person holds shares of capital stock in violation of the ownership limitations set forth in our charter, many types of entities may own directly more than the 9.8% limit because such entities' shares are attributed to its individual stockholders. On the other hand, a person will be treated as owning not only shares of capital stock actually or beneficially owned, but also any shares of capital stock attributed to such person under the attribution rules described above. Accordingly, under certain circumstances, shares of capital stock owned by a person who individually owns less than 9.8% of the shares outstanding may nevertheless be in violation of the ownership limitations set forth in our charter. Ownership of shares of capital stock through such attribution is generally referred to as constructive ownership.

If any transfer of shares of capital stock would result in any person beneficially or constructively owning capital stock in violation of our transfer or ownership limitations, then the number of shares of capital stock

## **Table of Contents**

causing the violation (rounded to the nearest whole shares) shall be automatically transferred to a trustee of a trust for the exclusive benefit of one or more charitable beneficiaries. The intended transferee shall not acquire any rights in such shares. Shares of capital stock held by the trustee shall be issued and outstanding shares of capital stock. The intended transferee shall not benefit economically from ownership of any shares held in the trust, shall have no rights to dividends, and shall not possess any rights to vote or other rights attributable to the shares held in the trust. The trustee shall have all voting rights and rights to dividends or other distributions with respect to shares held in the trust, which rights shall be exercised for the exclusive benefit of the charitable beneficiary. Any dividend or other distribution paid to the intended transferee prior to the discovery by us that shares of capital stock have been transferred to the trustee shall be paid with respect to such shares to the trustee by the intended transferee upon demand and any dividend or other distribution authorized but unpaid shall be paid when due to the trustee. Our board of directors may, in its discretion, waive these requirements on owning shares in excess of the ownership limitations.

Within 20 days of receiving notice from us that shares of capital stock have been transferred to the trust, the trustee shall sell the shares held in the trust to a person, designated by the trustee, whose ownership of the shares will not violate the ownership limitations set forth in our charter. Upon such sale, the interest of the charitable beneficiary in the shares sold shall terminate and the trustee shall distribute the net proceeds of the sale to the intended transferee and to the charitable beneficiary as follows. The intended transferee shall receive the lesser of (1) the price paid by the intended transferee for the shares or, if the intended transferee did not give value for the shares in connection with the event causing the shares to be held in the trust (e.g., in the case of a gift, devise or other such transaction), the market price (as defined below) of the shares on the day of the event causing the shares to be held in the trust, and (2) the price per share received by the trustee from the sale or other disposition of the shares held in the trust. Any net sales proceeds in excess of the amount payable to the intended transferee shall be immediately paid to the charitable beneficiary. In addition, shares of capital stock transferred to the trustee shall be deemed to have been offered for sale to us, or our designee. This offer shall be at a price per share equal to the lesser of (1) the price per share in the transaction that resulted in such transfer to the trust (or, in the case of a devise or gift, the market price at the time of such devise or gift), and (2) the market price on the date we, or our designee, accepts such offer. We shall have the right to accept such offer until the trustee has sold shares held in the trust. Upon such a sale to us, the interest of the charitable beneficiary in the shares sold shall terminate and the trustee shall distribute the net proceeds of the sale to the intended transferee.

The market price shall mean the last sale price for such shares. In case no such sale takes place on such day, the market price shall be the average of the closing bid and asked prices on the New York Stock Exchange. In the event that no trading price is available for such shares, the fair market value of the shares shall be as determined in good faith by our board of directors.

Under the REIT provisions of the tax code, every owner of 5% or more in the case of 2,000 or more stockholders of record, of 1% or more in the case of more than 200 but fewer than 2,000 stockholders of record and of 0.5% or more in the case of 200 or fewer stockholders of record, of all classes or series of our stock, is required to give written notice to us in response to our written demand for such notice, which request must be made within 30 days after the end of each taxable year. They shall state their name and address, the number of shares of each class and series of our stock beneficially owned and a description of the manner in which such shares are held. Each such owner shall provide to us such additional information as we may request in order to determine the effect, if any, of such beneficial ownership on our status as a REIT and to ensure compliance with the ownership limitations.

### **DESCRIPTION OF WARRANTS**

We have no warrants or other stock purchase rights outstanding other than options issued under our 2004 Equity Compensation Plan. We may issue warrants for the purchase of preferred stock or common stock. Warrants may be issued independently, together with any other securities offered by any prospectus supplement

## **Table of Contents**

or through a dividend or other distribution to our stockholders and may be attached to or separate from the related securities. Warrants may be issued under a warrant agreement to be entered into between us and a warrant agent specified in the applicable prospectus supplement. The warrant agent will act solely as our agent in connection with the warrants of a particular series and will not assume any obligation or relationship of agency or trust for or with any holders or beneficial owners of warrants. The following sets forth certain general terms and provisions of the warrants that may be offered under this prospectus. Further terms of the warrants and the applicable warrant agreement will be set forth in the applicable prospectus supplement.

The applicable prospectus supplement will describe the terms of the warrants in respect of which this prospectus is being delivered, including, where applicable, the following: (i) the title of the warrants; (ii) the aggregate number of the warrants; (iii) the price or prices at which the warrants will be issued; (iv) the designation, number and terms of the shares of preferred stock or common stock purchasable upon exercise of the warrants; (v) the designation and terms of the other securities, if any, with which the warrants are issued and the number of the warrants issued with each security; (vi) the date, if any, on and after which the warrants and the related preferred stock or common stock, if any, will be separately transferable; (vii) the price at which each share of preferred stock or common stock purchasable upon exercise of the warrants may be purchased; (viii) the date on which the right to exercise the warrants will commence and the date on which that right will expire; (ix) the minimum or maximum amount of the warrants which may be exercised at any one time; (x) information with respect to book-entry procedures, if any; (xi) a discussion of federal income tax considerations; and (xii) any other terms of the warrants, including terms, procedures and limitations relating to the transferability, exchange and exercise of the warrants.

## **SELECTED PROVISIONS OF MARYLAND LAW, OUR CHARTER AND BYLAWS**

The following summary of selected provisions of the Maryland General Corporation Law, as amended from time to time, and of our charter and bylaws does not purport to be complete and is subject to and qualified in its entirety by reference to Maryland law and to our charter and bylaws, copies of which are filed as exhibits to the registration statement of which this prospectus is a part.

### **Removal of Directors**

Our charter provides that a director may be removed from office at any time but only for cause and then only by the affirmative vote of the holders of at least two-thirds of the votes of the shares entitled to be cast in the election of directors.

### **Indemnification**

As permitted by Maryland law, our charter obligates us to indemnify our directors and officers to the maximum extent permitted by Maryland law. Maryland law permits a corporation to indemnify its present and former directors and officers, among others, against judgments, penalties, fines, settlements and reasonable expenses actually incurred by them in connection with any proceeding to which they may be made a party by reason of their service in those or other capacities, unless it is established that:

the act or omission of the director or officer was material to the matter giving rise to such proceeding and was committed in bad faith or was the result of active and deliberate dishonesty;

the director or officer actually received an improper personal benefit in money, property or services;

in the case of any criminal proceeding, the director or officer had reasonable cause to believe that the act or omission was unlawful; or

generally, the proceeding, other than a proceeding brought to enforce indemnification, is brought by the director or officer against us.

## **Table of Contents**

### **Limitation of Liability**

As permitted by Maryland law, our charter limits the liability of our directors and officers to us and our stockholders for money damages, except to the extent that:

it is proved that the person actually received an improper benefit or profit in money, property or services for the amount of the benefit or profit in money, property or services actually received; or

a judgment or other final adjudication adverse to the director or officer is entered in a proceeding based on a finding in the proceeding that the person's action, or failure to act, was the result of active and deliberate dishonesty and was material to the cause of action adjudicated in the proceeding.

As a result of these provisions, we and our stockholders may be unable to obtain monetary damages from a director or officer for breach of his or her duty of care.

### **Maryland Business Combination Act**

Maryland law prohibits specified business combinations between a Maryland corporation and an interested stockholder. These business combinations include, among others, a merger, consolidation, share exchange, asset transfer or issuance or reclassification of equity securities. Interested stockholders are either:

the beneficial owner, directly or indirectly, of 10% or more of the voting power of the then outstanding stock of the corporation; or

an affiliate or associate of the corporation who was the beneficial owner, directly or indirectly, of 10% or more of the voting power of the then outstanding stock of the corporation at any time within the two-year period prior to the date in question.

Business combinations with a past interested stockholder are prohibited for five years after the most recent date on which the stockholder became an interested stockholder. Thereafter, any business combinations with the interested stockholder must be recommended by the board of directors of the corporation and approved by the affirmative vote of at least:

80% of the votes entitled to be cast by outstanding shares of the corporation's voting shares, voting together as a single group; and

66 <sup>2</sup>/<sub>3</sub> % of the votes entitled to be cast by all holders of the corporation's voting shares other than voting shares held by the interested stockholder or an affiliate or associate of the interested stockholder.

However, these special voting requirements do not apply if the corporation's stockholders receive a minimum price for their shares, as specified in the statute, and the consideration is received in cash or in the same form previously paid by the interested stockholder for its shares.

The business combination statute does not apply to business combinations that are approved or exempted by the corporation's board of directors prior to the time that the interested stockholder becomes an interested stockholder. The statute also does not apply to stockholders that acquired 10% or more of the corporation's voting shares in a transaction approved by the corporation's board of directors. A Maryland corporation may adopt an amendment to its charter electing not to be subject to these special voting requirements. Any amendment would have to be approved by at least 80% of the votes entitled to be cast by all holders of outstanding shares of voting stock and 66 <sup>2</sup>/<sub>3</sub> % of the votes entitled to be cast by holders of outstanding shares of voting stock who are not interested stockholders or affiliates or associates of interested stockholders.



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The business combination statute could have the effect of discouraging offers to acquire us and of increasing the difficulty of consummating such offers, even if our acquisition would be in our stockholders' best interests. Our board of directors has not passed such a resolution exempting us from the business combination act.

## **Table of Contents**

### **Maryland Control Share Acquisition Act**

Maryland law provides that control shares of a Maryland corporation acquired in a control share acquisition have no voting rights unless approved by a vote of two-thirds of the votes entitled to be cast on the matter, excluding shares owned by the acquirer or by the corporation's officers or directors who are employees of the corporation. Control shares are shares of voting stock which, if aggregated with all other shares of stock previously acquired, would entitle the acquirer to exercise voting power in electing directors within one of the following ranges of voting power:

10% or more but less than  $33\frac{1}{3}\%$

$33\frac{1}{3}\%$  or more but less than a majority; or

a majority or more of all voting power.

Control shares do not include shares of stock an acquiring person is entitled to vote as a result of having previously obtained stockholder approval. A control share acquisition generally means the acquisition of, ownership of or the power to direct the exercise of voting power with respect to, control shares.

A person who has made or proposes to make a control share acquisition, under specified conditions, including an undertaking to pay expenses, may require the board of directors to call a special stockholders' meeting to consider the voting rights of the shares. The meeting must be held within 50 days of the demand. If no request for a meeting is made, the corporation may itself present the question at any stockholders' meeting.

If voting rights are not approved at the meeting or if the acquiring person does not deliver an acquiring person statement as permitted by the statute, the corporation generally may redeem any or all of the control shares, except those for which voting rights have previously been approved. This redemption of shares must be for fair value, determined without regard to the absence of voting rights for the control shares as of the date of the last control share acquisition by the acquiring person or of any stockholders' meeting at which the voting rights of the shares are considered and not approved. If voting rights for control shares are approved at a stockholders' meeting and the acquirer becomes entitled to vote a majority of the shares entitled to vote, all other stockholders may exercise appraisal rights. The fair value of the stock determined for purposes of appraisal rights may not be less than the highest price per share paid by the acquiring person in the control share acquisition. Certain limitations and restrictions otherwise applicable to the exercise of dissenters' rights do not apply in the context of a control share acquisition.

The control share acquisition statute would not apply to stock acquired in a merger, consolidation or share exchange if we were a party to the transaction, or to acquisitions previously approved or exempted by a provision in our charter or bylaws.

Our bylaws currently contain a provision exempting from the control share acquisition statute any and all acquisitions by any person of our common stock. However, our board of directors may decide to amend or eliminate this provision at any time in the future.

### **Amendment of Our Charter**

We reserve the right from time to time to make any amendment to our charter including any amendment that alters the contract rights as expressly set forth in our charter of any shares of outstanding stock, subject to certain limitations. Our charter may be amended only by the affirmative vote of holders of shares entitled to cast not less than a majority of all the votes entitled to be cast on the matter. The provisions in our charter on removal of directors may be amended only by the affirmative vote of holders of shares entitled to cast not less than two-thirds of all the votes entitled to be cast in the election of directors.

## **Table of Contents**

### **CERTAIN FEDERAL INCOME TAX CONSIDERATIONS**

The following discussion summarizes particular U.S. federal income tax considerations regarding our qualification and taxation as a REIT and particular U.S. federal income tax consequences resulting from the acquisition, ownership and disposition of our capital stock and warrants. Based on various factual representations made by us regarding our operations, as well as the legal opinions of a national law firm previously given to us as to our qualification as a REIT under the Code for our taxable year ended December 31, 1998 through and including our taxable year ended December 31, 2008, in the opinion of Greenberg Traurig, LLP, commencing with our taxable year ended on December 31, 1998, we have been organized in conformity with the requirements for qualification as a REIT under the Code, and our method of operating has enabled us, and will enable us, to meet the requirements for qualification and taxation as a REIT. Accordingly, we believe, and the foregoing discussion assumes, that we have qualified at all times throughout our existence, and will continue to qualify, as a REIT for U.S. federal income tax purposes. The tax law upon which this discussion is based could be changed and any such change could have a retroactive effect. The following discussion is not exhaustive of all possible tax considerations. This summary neither gives a detailed discussion of any state, local or foreign tax considerations nor discusses all of the aspects of U.S. federal income taxation that may be relevant to you in light of your particular circumstances or to particular types of stockholders and warrant holders which are subject to special tax rules, such as insurance companies, tax-exempt entities, financial institutions or broker-dealers, foreign corporations or partnerships and persons who are not citizens or residents of the U.S., stockholders that hold our stock as a hedge, part of a straddle, conversion transaction or other arrangement involving more than one position, or stockholders whose functional currency is not the U.S. dollar. This discussion assumes that you will hold our capital stock as a capital asset, generally property held for investment, under the Code.

We urge you to consult with your own tax advisor regarding the specific consequences to you of the acquisition, ownership and disposition of stock or warrants in an entity electing to be taxed as a REIT, including the federal, state, local, foreign and other tax considerations of such acquisition, ownership, disposition and election and the potential changes in applicable tax laws.

#### **General**

Our qualification and taxation as a REIT depends upon our ability to continue to meet the various qualification tests, imposed under the Code and discussed below, relating to our actual annual operating results, asset diversification, distribution levels and diversity of stock ownership. Accordingly, the actual results of our operations for any particular taxable year may not satisfy these requirements.

We have made an election to be taxed as a REIT under the Code commencing with our taxable year ended December 31, 1998. We currently expect to continue operating in a manner that will permit us to maintain our qualification as a REIT. All qualification requirements for maintaining our REIT status, however, may not have been, or might not continue to be, met.

So long as we qualify for taxation as a REIT, we generally will be permitted a deduction for dividends we pay to our stockholders. As a result, we generally will not be required to pay federal corporate income taxes on our net income that is currently distributed to our stockholders. This treatment substantially eliminates the double taxation that ordinarily results from investment in a corporation. Double taxation means taxation once at the corporate level when income is earned and once again at the stockholder level when this income is distributed. We will be required to pay federal income tax, however, as follows:

we will be required to pay tax at regular corporate rates on any undistributed real estate investment trust taxable income, including undistributed net capital gains;

we may be required to pay the alternative minimum tax on our items of tax preference; and

if we have (i) net income from the sale or other disposition of foreclosure property which is held primarily for sale to customers in the ordinary course of business, or (ii) other non-qualifying income

## **Table of Contents**

from foreclosure property, we will be required to pay tax at the highest corporate rate on this income. Foreclosure property is generally defined as property acquired through foreclosure or after a default on a loan secured by the property or on a lease of the property.

To the extent that distributions exceed current and accumulated earnings and profits, they will constitute a return of capital, rather than dividend or capital gain income, and will reduce the basis for the stockholder's stock with respect to which the distributions are paid or, to the extent that they exceed such basis, will be taxed in the same manner as gain from the sale of that stock. For purposes of determining whether distributions are out of current or accumulated earnings and profits, our earnings and profits will be allocated first to our preferred stock (as compared to distributions with respect to our common stock) so that distributions with respect to our preferred stock are more likely to be treated as dividends than as return of capital or a distribution in excess of basis. Calculations of corporate earnings and profits are complex and it is possible that distributions expected to be a return of capital may subsequently be determined to be taxable distributions of earnings and profits.

Currently, dividends paid by regular C corporations to stockholders other than corporations are generally taxed at the rate applicable to long-term capital gains, which is currently a maximum of 20%, subject to certain limitations. Because we are a REIT, however, our dividends, including dividends paid on our Series A Preferred Stock and Series B Preferred Stock, generally will continue to be taxed at regular ordinary income tax rates, except in limited circumstances.

We will be required to pay a 100% tax on any net income from prohibited transactions. Prohibited transactions are, in general, sales or other taxable dispositions of property other than foreclosure property held primarily for sale to customers in the ordinary course of business. While the Code contains certain safe harbors provisions to avoid the application of this 100% tax, outside of the safe harbor, the determination of whether property is held as inventory or primarily for sale to customers in the ordinary course of a trade or business depends on all the facts and circumstances surrounding the particular transaction. No assurance can be given that any particular property in which we hold a direct or indirect interest will not be treated as property held for sale to customers, or that we can comply with certain safe harbor provisions of the Code that would prevent such treatment. The 100% tax will not apply to gains from the sale of property that is held through a taxable REIT subsidiary or other taxable corporation, although such income will be taxed to the corporation at regular corporate tax rates.

If we fail to satisfy the 75% gross income test or the 95% gross income test discussed below but nonetheless maintain our qualification as a REIT because certain other requirements are met, we will be subject to a tax equal to the greater of (i) the amount by which 75% of our gross income exceeds the amount qualifying under the 75% gross income test described below, and (ii) the amount by which 95% of our gross income exceeds the amount qualifying under the 95% gross income test described below, multiplied by a fraction intended to reflect our profitability.

In the event of more than de minimis failure of any of the asset tests occurs in a taxable year, as long as the failure was due to reasonable cause and not to willful neglect and we dispose of the assets or otherwise comply with the asset tests within six months after the last day of the quarter in which we identify such failure, we will pay a tax equal to the greater of \$50,000 or 35% of the net income from the non-qualifying assets during the period in which we failed to satisfy any of the asset tests.

In the event of a failure to satisfy one or more requirements for REIT qualification occurring in a taxable year, other than the gross income tests and the asset tests, as long as such failure was due to reasonable cause and not to willful neglect, we will be required to pay a penalty of \$50,000 for each such failure.

We will be required to pay a nondeductible 4% excise tax on the excess of the required distribution over the amounts actually distributed if we fail to distribute during each calendar year at least the sum of:

85% of our real estate investment trust ordinary income for the year;

## **Table of Contents**

95% of our real estate investment trust capital gain net income for the year; and

any undistributed taxable income from prior periods.

This distribution requirement is in addition to, and different from, the distribution requirements discussed below in the section entitled Annual Distribution Requirements.

We may elect to retain and pay income tax on our net long-term capital gain. In that case, a U.S. stockholder would be taxed on its proportionate share of our undistributed long-term capital gain (to the extent that we make a timely designation of such gain to the stockholder) and would receive a credit or refund of its proportionate share of the tax we paid. The basis of the stockholder's shares is increased by the amount of the undistributed long-term capital gain (less the amount of capital gains tax paid by the REIT) included in the stockholder's long-term capital gains.

If we own a residual interest in a REMIC, we will be taxable at the highest corporate rate on the portion of any excess inclusion income that we derive from the REMIC residual interests equal to the percentage of our stock that is held by disqualified organizations. Although the law is unclear, similar rules may apply if we own an equity interest in a taxable mortgage pool. To the extent that we own a REMIC residual interest in a taxable mortgage pool through a taxable REIT subsidiary, we will not be subject to tax. A disqualified organization includes:

the United States of America;

any state or political subdivision of the United States of America;

any foreign government;

any international organization;

any agency or instrumentality of any of the foregoing;

any other tax-exempt organization other than a farmers' cooperative described in Section 521 of the Code that is exempt both from income taxation and from taxation under the unrelated business taxable income provisions of the Code; and

any rural electrical or telephone cooperative.

If we acquire any asset from a corporation which is or has been taxed as a C corporation under the Code in a transaction in which the basis of the asset in our hands is determined by reference to the basis of the asset in the hands of the C corporation and we subsequently recognize gain on the disposition of the asset during the ten-year period beginning on the date on which we acquired the asset, then we will be required to pay tax at the highest regular corporate tax rate on this gain to the extent of the excess of:

the fair market value of the asset, over

our adjusted basis in the asset,

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in each case determined as of the date on which we acquired the asset.

A C corporation is generally defined as a corporation required to pay full corporate-level tax. The results described in the preceding paragraph with respect to the recognition of gain will apply unless we make an election under Treasury Regulation Section 1.337(d)-7(c). If such an election were made, the C corporation would recognize taxable gain or loss as if it had sold the assets we acquired from the C corporation to an unrelated third party at fair market value on the acquisition date.

We will be subject to a 100% excise tax if our dealings with any taxable REIT subsidiaries (defined below) are not at arm's length.

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## **Table of Contents**

In addition, notwithstanding our REIT status, we may also have to pay certain state and local income taxes, because not all states and localities treat REITs in the same manner as they are treated for federal income tax purposes.

### **Requirements for Qualification as a REIT**

The Code defines a REIT as a corporation, trust or association:

1. that is managed by one or more trustees or directors;
2. that issues transferable shares or transferable certificates to evidence beneficial ownership;
3. that would be taxable as a domestic corporation but for Code Sections 856 through 859;
4. that is not a financial institution or an insurance company within the meaning of the Code;
5. that is beneficially owned by 100 or more persons;
6. that not more than 50% in value of the outstanding stock of which is owned, actually or constructively, by five or fewer individuals, including specified entities, during the last half of each taxable year;
7. that meets other tests, described below, regarding the nature of its income and assets and the amount of its distributions; and
8. that elects to be a REIT or has made such election for a previous taxable year and satisfies all relevant filing and other administrative requirements established by the Internal Revenue Service, or the IRS, that must be met to elect and retain REIT status.

The Code provides that all of the first four conditions stated above must be met during the entire taxable year, the fifth condition must be met during at least 335 days of a taxable year of twelve months, or during a proportionate part of a taxable year of less than twelve months, and the sixth condition must be met during the last half of each taxable year. The fifth and sixth conditions do not apply until after the first taxable year for which an election is made to be taxed as a REIT.

For purposes of the sixth condition, pension trusts and other specified tax-exempt entities generally are treated as individuals, except that a look-through exception generally applies with respect to trusts that are taxable under Section 401(a) of the Code that are tax-exempt under Section 501(a) of the Code, i.e., pension funds.

### **Stock Ownership Tests**

Our stock must be beneficially held by at least 100 persons, the 100 Stockholder Rule, and no more than 50% of the value of our stock may be owned, directly or indirectly, by five or fewer individuals at any time during the last half of the taxable year, the 5/50 Rule. For purposes of the 100 Stockholder Rule only, trusts described in Section 401(a) of the Code and exempt under Section 501(a) of the Code are generally treated as persons. For purposes of the 5/50 Rule, stock owned by trusts that are taxable under Section 401(a) of the Code that are tax-exempt under Section 501(a) of the Code is treated as held by the trust's beneficiaries ( Pension Fund Look-Through ). A REIT that must rely on the Pension Fund Look-Through in order to satisfy the 5/50 Rule may be considered to be a pension-held REIT, which may have implications for the REIT's pension fund shareholders. These stock ownership requirements must be satisfied in each taxable year other than the first taxable year for which an election is made to be taxed as a REIT. We are required to solicit information from certain of our record stockholders to verify actual stock ownership levels and our charter provides for restrictions regarding the transfer of our stock in order to aid in meeting the stock ownership

requirements. If we were to fail either of the stock ownership tests, we would generally be disqualified from our REIT status. However, if we comply with regulatory rules pursuant to which we are required to send annual letters to holders of our stock



## **Table of Contents**

requesting information regarding the actual ownership of our stock, and we do not know, or exercising reasonable diligence would not have known, whether we failed to meet the 5/50 Rule, we will be treated as having met the 5/50 Rule.

### **Income Tests**

We must satisfy two gross income requirements annually to maintain our qualification as a REIT:

We must derive, directly or indirectly, at least 75% of our gross income, excluding gross income from prohibited transactions, from specified real estate sources, including rental income, interest on obligations secured by mortgages on real property or on interests in real property, gain from the disposition of qualified real estate assets, i.e., interests in real property, mortgages secured by real property or interests in real property, and some other assets, income from certain types of temporary investments, amounts, such as commitment fees, received in consideration for entering into an agreement to make a loan secured by real property, unless such amounts are determined by income and profits, and income derived from a REMIC in proportion to the real estate assets held by the REMIC, unless at least 95% of the REMIC's assets are real estate assets (in which case, all of the income derived from the REMIC), or the 75% gross income test; and

We must derive at least 95% of our gross income, excluding gross income from prohibited transactions, from (i) the sources of income that satisfy the 75% gross income test, (ii) dividends, interest and gain from the sale or disposition of stock or securities, or (iii) any combination of the foregoing, or the 95% gross income test.

Gross income from servicing loans for third parties is not qualifying income for purposes of either gross income test. Gross income from loan origination fees may qualify for purposes of the gross income tests depending upon whether or not the nature of the fees is charges for the forbearance of money. If so, such fee income may qualify as a form of interest, otherwise such income is not qualifying income for purposes of either gross income test. Gross income from our sale of property that we hold primarily for sale to customers in the ordinary course of business is excluded from both the numerator and the denominator in both income tests. Income and gain from certain transactions that we enter into to hedge indebtedness incurred or to be incurred to acquire or carry real estate assets, and that are clearly and timely identified as such, are excluded from both the numerator and denominator for purposes of the 95% gross income test and, for certain hedging transactions entered into after July 30, 2008, the 75% gross income test.

For purposes of the 75% and 95% gross income tests, a REIT is deemed to have earned a proportionate share of the income earned by any partnership, or any limited liability company treated as a partnership for federal income tax purposes, in which it owns an interest, which share is determined by reference to its capital interest in such entity, and is deemed to have earned the income earned by any qualified REIT subsidiary (in general, a 100%-owned corporate subsidiary of a REIT). Interest earned by a REIT ordinarily does not qualify as income meeting the 75% or 95% gross income tests if the determination of all or some of the amount of interest depends in any way on the income or profits of any person. Interest will not be disqualified from meeting such tests, however, solely by reason of being based on a fixed percentage or percentages of receipts or sales.

The following paragraphs discuss in more detail the specific application of the gross income tests to us.

*Interest.* The term interest, as defined for purposes of both gross income tests, generally excludes any amount that is based in whole or in part on the income or profits of any person. However, interest generally includes the following:

an amount that is based on a fixed percentage or percentages of receipts or sales; and

an amount that is based on the income or profits of a debtor as long as the debtor derives substantially all of its income from the real property securing the debt from leasing substantially

## **Table of Contents**

all of its interest in the property and only to the extent that the amounts received by the debtor would be qualifying rents from real property if received directly by a REIT.

If a loan contains a provision that entitles a REIT to a percentage of the borrower's gain upon the sale of the real property securing the loan or a percentage of the appreciation in the property's value as of a specific date, income attributable to that loan provision will generally be treated as gain from the sale of the property securing the loan, which normally constitutes qualifying income for purposes of both gross income tests.

Interest on debt secured by a mortgage on real property or on interests in real property, including, for this purpose, discount points, prepayment penalties, loan assumption fees and late payment charges that are not compensation for services, generally is qualifying income for purposes of the 75% gross income test. However, if the highest principal amount of a loan outstanding during a taxable year exceeds the fair market value of the real property securing the loan as of the date the REIT agreed to originate or acquire the loan, a portion of the interest income from such loan will not be qualifying income for purposes of the 75% gross income test but will be qualifying income for purposes of the 95% gross income test. The portion of the interest income that will not be qualifying income for purposes of the 75% gross income test will be equal to the portion of the principal amount of the loan that is not secured by real property—that is, the amount by which the loan exceeds the value of the real estate that is security for the loan.

The interest, original issue discount and market discount income that we receive from our mortgage loans and MBS generally will be qualifying income for purposes of both gross income tests. However, as discussed above, if the fair market value of the real estate securing any of our loans is less than the principal amount of the loan, a portion of the income from that loan will be qualifying income for purposes of the 95% gross income test but not the 75% gross income test.

*Fee Income.* We may receive various fees in connection with originating mortgage loans. The fees will be qualifying income for purposes of both the 75% and 95% income tests if they are received in consideration for entering into an agreement to make a loan secured by real property and the fees are not determined based on the borrower's income or profits. Therefore, commitment fees will generally be qualifying income for purposes of the income tests. Other fees, such as fees received for servicing loans for third parties and origination fees, are not qualifying income for purposes of either income test.

*Dividends.* Our share of any dividends received from any corporation (including any of our taxable REIT subsidiaries, but excluding any REIT) in which we own an equity interest will qualify for purposes of the 95% gross income test but not for purposes of the 75% gross income test. Our share of any dividends received from any other REIT in which we own an equity interest will be qualifying income for purposes of both gross income tests.

*Rents from Real Property.* We do not intend to acquire any real property, but we may acquire real property or an interest therein in the future. To the extent that we acquire real property or an interest therein, rents we receive will qualify as rents from real property in satisfying the gross income requirements for a REIT described above only if the following conditions are met:

First, the amount of rent must not be based, in whole or in part, on the income or profits of any person. However, an amount received or accrued generally will not be excluded from rents from real property solely by reason of being based on fixed percentages of receipts or sales.

Second, rents we receive from a related party tenant will not qualify as rents from real property in satisfying the gross income tests unless the tenant is a taxable REIT subsidiary, at least 90% of the property is leased to unrelated tenants and the rent paid by the taxable REIT subsidiary is substantially comparable to the rent paid by the unrelated tenants for comparable space. A tenant is a related party tenant if the REIT, or an actual or constructive owner of 10% or more of the REIT, actually or constructively owns 10% or more of the tenant.

## **Table of Contents**

Third, if rent attributable to personal property leased in connection with a lease of real property is greater than 15% of the total rent received under the lease, then the portion of rent attributable to the personal property will not qualify as rents from real property.

Fourth, we generally must not operate or manage our real property or furnish or render services to our tenants, other than through an independent contractor who is adequately compensated and from whom we do not derive revenue. However, we may provide services directly to tenants if the services are usually or customarily rendered in connection with the rental of space for occupancy only and are not considered to be provided for the tenants' convenience. In addition, we may provide a minimal amount of non-customary services to the tenants of a property, other than through an independent contractor, as long as our income from the services does not exceed 1% of our income from the related property. Furthermore, we may own up to 100% of the stock of a taxable REIT subsidiary, which may provide customary and non-customary services to tenants without tainting its rental income from the related properties.

*Hedging Transactions.* From time to time, we may enter into hedging transactions with respect to one or more of our assets or liabilities. Our hedging activities may include entering into interest rate swaps, caps and floors, options to purchase these items and futures and forward contracts. Income and gain from hedging transactions will be excluded from gross income for purposes of the 95% gross income test and, for certain hedging transactions entered into after July 30, 2008, the 75% gross income test. A hedging transaction includes any transaction entered into in the normal course of our trade or business primarily to manage the risk of interest rate, price changes or currency fluctuations with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, to acquire or carry real estate assets. We will be required to clearly identify any such hedging transaction before the close of the day on which it was acquired, originated or entered into. To the extent that we hedge for other purposes, or to the extent that a portion of our mortgage loans is not secured by real estate assets (as described below under *Asset Tests*), or in other situations, the income from those transactions is not likely to be treated as qualifying income for purposes of the 95% gross income test. We intend to structure any hedging transactions in a manner that does not jeopardize our status as a REIT.

*Prohibited Transactions.* As discussed above, a REIT will incur a 100% tax on the net income derived from any sale or other disposition of property other than foreclosure property that the REIT holds primarily for sale to customers in the ordinary course of a trade or business. We believe that none of our assets will be held primarily for sale to customers and that a sale of any of our assets will not be in the ordinary course of our business. Whether a REIT holds an asset primarily for sale to customers in the ordinary course of a trade or business depends, however, on the facts and circumstances in effect from time to time, including those related to a particular asset. Nevertheless, we will attempt to comply with the terms of safe-harbor provisions in the federal income tax laws prescribing when an asset sale will not be characterized as a prohibited transaction.

Foreign currency gain or loss that is attributable to any prohibited transaction is taken into account in determining the amount of prohibited transaction net income subject to the 100% tax.

*Foreclosure Property.* We will be subject to tax at the maximum corporate rate on any income from foreclosure property other than income that otherwise would be qualifying income for purposes of the 75% gross income test, less expenses directly connected with the production of that income. However, gross income from foreclosure property will qualify under the 75% and 95% gross income tests. Foreclosure property is any real property, including interests in real property, and any personal property incident to such real property:

that is acquired by a REIT as the result of the REIT having bid on such property at foreclosure, or having otherwise reduced such property to ownership or possession by agreement or process of law, after there was a default or default was imminent on a lease of such property or on indebtedness that such property secured;

for which the related loan or lease was acquired by the REIT at a time when the default was not imminent or anticipated; and

## **Table of Contents**

for which the REIT makes a proper election to treat the property as foreclosure property.

Permitted foreclosure property income also includes foreign currency gain that is attributable to otherwise permitted income from foreclosure property. Such foreign currency gain also is included as foreclosure property income for purposes of any tax on such income.

However, a REIT will not be considered to have foreclosed on a property where the REIT takes control of the property as a mortgagee-in-possession and cannot receive any profit or sustain any loss except as a creditor of the mortgagor. Property generally ceases to be foreclosure property at the end of the third taxable year following the taxable year in which the REIT acquired the property or longer if an extension is granted by the Secretary of the Treasury. This grace period terminates and foreclosure property ceases to be foreclosure property on the first day:

on which a lease is entered into for the property that, by its terms, will give rise to income that does not qualify for purposes of the 75% gross income test or any amount is received or accrued, directly or indirectly, pursuant to a lease entered into on or after such day that will give rise to income that does not qualify for purposes of the 75% gross income test;

on which any construction takes place on the property, other than completion of a building or any other improvement, where more than 10% of the construction was completed before default became imminent; or

which is more than 90 days after the day on which the REIT acquired the property and the property is used in a trade or business which is conducted by the REIT other than through an independent contractor from whom the REIT itself does not derive or receive any income.

*Failure to Satisfy Gross Income Tests.* If we fail to satisfy one or both of the gross income tests for any taxable year, we nevertheless may qualify as a REIT for that year if we qualify for relief under certain provisions of the federal income tax laws. Those relief provisions will be available if:

our failure to meet those tests is due to reasonable cause and not to willful neglect, and

following such failure for any taxable year, a schedule of the sources of our income is filed in accordance with regulations prescribed by the Secretary of the Treasury.

We cannot predict, however, whether in all circumstances we would qualify for the relief provisions. In addition, as discussed above, even if the relief provisions apply, we would incur a 100% tax on the gross income attributable to the greater of (i) the amount by which we fail the 75% gross income test or (ii) the amount by which 95% of our gross income exceeds the amount of our income qualifying under the 95% gross income test, multiplied, in either case, by a fraction intended to reflect our profitability.

## **Foreign Investment and Exchange Gains**

A REIT must be a U.S. domestic entity, but it is permitted to hold foreign real estate or other foreign-based assets, provided the 75% and 95% income tests and other requirements for REIT qualification are met. A REIT that holds foreign real estate or other foreign-based assets may have foreign currency exchange gain under the foreign currency transaction tax rules. Foreign currency exchange gain was not explicitly included in the statutory definitions of qualifying income for purposes of the 75% and 95% income tests until a statutory change, although the IRS issued guidance that allowed foreign currency gain to be treated as qualified income in certain circumstances.

For transactions occurring after July 30, 2008, the provision excludes certain foreign currency gain from the computation of qualifying income for purposes of the 75% income test or the 95% income test, respectively. The exclusion is solely for purposes of the computations under these tests.

## **Table of Contents**

The statutory change defines two new categories of income for purposes of the exclusion rules: real estate foreign exchange gain and passive foreign exchange gain. Real estate foreign exchange gain is excluded from gross income for purposes of both the 75% and the 95% income tests. Passive foreign exchange gain is excluded for purposes of the 95% income test but is included in gross income and treated as non-qualifying income, to the extent that it is not real estate foreign exchange gain, for purposes of the 75% income test.

Real estate foreign exchange gain is foreign currency gain which is attributable to: (i) any item of income qualifying for the numerator for the 75% income test; (ii) the acquisition or ownership of obligations secured by mortgages on real property or interests in real property; or (iii) becoming or being the obligor under obligations secured by mortgages on real property or interests in real property. Real estate foreign exchange gain also includes certain foreign currency gains attributable to certain qualified business units of the REIT.

Passive foreign exchange gain includes all real estate foreign exchange and, in addition, includes foreign currency gain which is attributable to: (i) any item of income or gain included in the numerator for the 95% income test, (ii) acquisition or ownership of obligations other than described in the preceding paragraph; (iii) becoming the obligor under obligations other than described in the preceding paragraph; and (iv) any other foreign currency gain to be determined by the IRS.

Notwithstanding the foregoing rules, except in the case of certain income excluded under the hedging rules, foreign currency exchange gain derived from engaging in dealing, or substantial and regular trading, in certain securities shall constitute gross income that does not qualify under either the 75% or 95% income test.

## **Asset Tests**

To qualify as a REIT, we also must satisfy the following asset tests at the end of each quarter of each taxable year:

First, at least 75% of the value of our total assets must consist of:

cash or cash items, including certain receivables;

government securities;

interests in real property, including leaseholds and options to acquire real property and leaseholds;

interests in mortgage loans secured by real property;

stock in other REITs;

investments in stock or debt instruments during the one-year period following our receipt of new capital that we raise through equity offerings or public offerings of debt with at least a five-year term; and

regular or residual interests in a REMIC. However, if less than 95% of the assets of a REMIC consist of assets that are qualifying real estate-related assets under the federal income tax laws, determined as if we held such assets, we will be treated as holding directly our proportionate share of the assets of such REMIC.

The term cash for purposes of the REIT asset qualification rules is defined to include foreign currency if the REIT or its qualified business unit uses such foreign currency as its functional currency, but only to the extent such foreign currency is held for use in the normal course of the activities of the REIT or the qualified business unit giving rise to income in the numerator for the 75% or 95% income tests, or directly related to acquiring or holding assets qualifying for the numerator in the 75% assets test, and is not held in connection with a trade or business of trading or dealing in certain securities.

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Second, not more than 25% of the value of our total assets may be represented by securities (other than those included in the preceding category).

## **Table of Contents**

Third, not more than 25% of the value of our total assets may be represented by securities of one or more taxable REIT subsidiaries.

Fourth, except with respect to a taxable REIT subsidiary and securities includible in the first category above, (i) not more than 5% of the value of our total assets may be represented by securities of any one issuer, (ii) we may not hold securities possessing more than 10% of the total voting power of the outstanding securities of any one issuer and (iii) we may not hold securities having a value of more than 10% of the total value of the outstanding securities of any one issuer.

For purposes of the second and third asset tests, the term "securities" does not include stock in another REIT, equity or debt securities of a qualified REIT subsidiary or taxable REIT subsidiary, mortgage loans that constitute real estate assets, or equity interests in a partnership. For purposes of the 10% value test, the term "securities" does not include:

Straight debt securities, which is defined as a written unconditional promise to pay on demand or on a specified date a sum certain in money if (i) the debt is not convertible, directly or indirectly, into stock, and (ii) the interest rate and interest payment dates are not contingent on profits, the borrower's discretion, or similar factors. Straight debt securities do not include any securities issued by a partnership or a corporation in which we or any controlled taxable REIT subsidiary (i.e., a taxable REIT subsidiary in which we own directly or indirectly more than 50% of the voting power or value of the stock) hold non- straight debt securities that have aggregate value of more than 1% of the issuer's outstanding securities. However, straight debt securities include debt subject to the following contingencies:

a contingency relating to the time of payment of interest or principal, as long as either (i) there is no change to the effective yield of the debt obligation other than a change to the annual yield that does not exceed the greater of 0.25% or 5% of the annual yield, or (ii) neither the aggregate issue price nor the aggregate face amount of the issuer's debt obligations held by us exceeds \$1 million and no more than 12 months of unaccrued interest on the debt obligations can be required to be prepaid; and

a contingency relating to the time or amount of payment upon a default or prepayment of a debt obligation, as long as the contingency is consistent with customary commercial practice.

Any loan to an individual or an estate.

Any section 467 rental agreement other than an agreement with a related party tenant.

Any obligation to pay rents from real property.

Certain securities issued by governmental entities.

Any security issued by a REIT.

Any debt instrument of an entity treated as a partnership for federal income tax purposes to the extent of our interest as a partner in the partnership.

Any debt instrument of an entity treated as a partnership for federal income tax purposes not described in the preceding bullet points if at least 75% of the partnership's gross income, excluding income from prohibited transaction, is qualifying income for purposes of

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the 75% gross income test described above in Income Tests.

The asset tests described above are based on our gross assets. For federal income tax purposes, we will be treated as owning both the loans we hold directly and the loans that we have securitized through non-REMIC debt securitizations. Although we will have a partially offsetting obligation with respect to the securities issued pursuant to the securitizations, these offsetting obligations will not reduce the gross assets we are considered to own for purposes of the asset tests.



## Table of Contents

We believe that all or substantially all of the mortgage loans and MBS that we will own will be qualifying assets for purposes of the 75% asset test. For purposes of these rules, however, if the outstanding principal balance of a mortgage loan exceeds the fair market value of the real property securing the loan, a portion of such loan likely will not be a qualifying real estate asset under the federal income tax laws. Although the law on the matter is not entirely clear, it appears that the non-qualifying portion of that mortgage loan will be equal to the portion of the loan amount that exceeds the value of the associated real property that is security for that loan. To the extent that we own debt securities issued by other REITs or C corporations that are not secured by a mortgage on real property, those debt securities will not be qualifying assets for purposes of the 75% asset test. Instead, we would be subject to the second, third and fourth asset tests with respect to those debt securities.

Revenue Procedure 2011-16 discusses the modification of a mortgage loan (or an interest therein) that is held by a REIT in which the modification was occasioned by either a default on the loan or a modification that satisfies both of the following conditions: (i) based on all the facts and circumstances, the REIT or servicer of the loan (the pre-modified loan) reasonably believes that there is a significant risk of default of the pre-modified loan upon maturity of the loan or at an earlier date, and (ii) based on all the facts and circumstances, the REIT or servicer reasonably believes that the modified loan presents a substantially reduced risk of default, as compared with the pre-modified loan. Revenue Procedure 2011-16 provides that a REIT may treat a modification of a mortgage loan described therein as not being a new commitment to make or purchase a loan for purposes of apportioning interest on that loan between interest with respect to real property or other interest. The modification will also not be treated as a prohibited transaction. Further, with respect to the REIT asset test, the IRS will not challenge the REIT's treatment of a loan as being in part a real estate asset if the REIT treats the loan as being a real estate asset in an amount equal to the lesser of (a) the value of the loan as determined under Treasury Regulations Section 1.856-3(a), or (b) the loan value of the real property securing the loan as determined under Treasury Regulations Section 1.856-5(c) and Revenue Procedure 2011-16.

We will monitor the status of our assets for purposes of the various asset tests and will seek to manage our investment portfolio to comply at all times with such tests. There can be no assurance, however, that we will be successful in this effort. In this regard, to determine our compliance with these requirements, we will need to estimate the value of the real estate securing our mortgage loans at various times. Although we will seek to be prudent in making these estimates, there can be no assurances that the IRS might not disagree with these determinations and assert that a lower value is applicable. If we fail to satisfy the asset tests at the end of a calendar quarter, we will not lose our REIT status if:

we satisfied the asset tests at the end of the preceding calendar quarter; and

the discrepancy between the value of our assets and the asset test requirements arose from changes in the market values of our assets and was not wholly or partly caused by the acquisition of one or more non-qualifying assets, or solely by a change in the foreign currency exchange rate used to value a foreign asset.

If we did not satisfy the condition described in the second item, above, we still could avoid disqualification by eliminating any discrepancy within 30 days after the close of the calendar quarter in which it arose.

In the event that, at the end of any calendar quarter, we violate the second or third asset tests described above, we will not lose our REIT status if (i) the failure is de minimis (up to the lesser of 1% of our assets or \$10 million) and (ii) we dispose of assets or otherwise comply with the asset tests within six months after the last day of the quarter in which we identify such failure. In the event of a more than de minimis failure of any of the asset tests, as long as the failure was due to reasonable cause and not to willful neglect, we will not lose our REIT status if (i) we dispose of assets or otherwise comply with the asset tests within six months after the last day of the quarter in which we identify such failure and (ii) pay a tax equal to the greater of \$50,000 or 35% of the net income from the non-qualifying assets during the period in which we failed to satisfy the asset tests.

We currently believe that the securities and other assets that we expect to hold will satisfy the foregoing asset test requirements. However, no independent appraisals will be obtained to support our conclusions as to the

## **Table of Contents**

value of our assets and securities, or in many cases, the real estate collateral for the mortgage loans that we hold. Moreover, the values of some assets may not be susceptible to a precise determination. As a result, there can be no assurance that the IRS will not contend that our ownership of securities and other assets violates one or more of the asset tests applicable to REITs.

### **Annual Distribution Requirements**

Each taxable year, we must distribute dividends, other than capital gain dividends and deemed distributions of retained capital gain, to our stockholders in an aggregate amount at least equal to the sum of:

90% of our REIT taxable income, computed without regard to the dividends paid deduction and our net capital gain or loss, and

90% of our after-tax net income, if any, from foreclosure property, minus

the sum of certain items of excess non-cash income.

We must pay such distributions in the taxable year to which they relate or in the following taxable year if we declare the distribution before we timely file our federal income tax return for the year and pay the distribution on or before the first regular dividend payment date after such declaration. In addition, dividends declared in October, November or December payable to stockholders of record in such month are deemed received by stockholders on December 31 and to have been paid on December 31 if actually paid in January of the following year. See below under Distributions Generally.

We will pay the federal income tax on taxable income, including net capital gain, which we do not distribute to stockholders. Furthermore, if we fail to distribute during a calendar year, or by the end of January following the calendar year in the case of distributions with declaration and record dates falling in the last three months of the calendar year, at least the sum of:

85% of our REIT ordinary income for such year,

95% of our REIT capital gain income for such year, and

any undistributed taxable income from prior periods,

we will incur a 4% nondeductible excise tax on the excess of such required distribution over the amounts we actually distribute. We may elect to retain and pay income tax on the net long-term capital gain we receive in a taxable year. See Taxation of Taxable U.S. Stockholders. If we so elect, we will be treated as having distributed any such retained amount for purposes of the 4% nondeductible excise tax described above. We intend to make timely distributions sufficient to satisfy the annual distribution requirements and to avoid corporate income tax and the 4% nondeductible excise tax.

It is possible that, from time to time, we may experience timing differences between the actual receipt of income and actual payment of deductible expenses and the inclusion of that income and deduction of such expenses in arriving at our REIT taxable income. Possible examples of those timing differences include the following:

Because we may deduct capital losses only to the extent of our capital gains, we may have taxable income that exceeds our economic income.

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We will recognize taxable income in advance of the related cash flow if any of our mortgage loans or MBS are deemed to have original issue discount. We generally must accrue original issue discount based on a constant yield method that takes into account projected prepayments but that defers taking into account credit losses until they are actually incurred.

We may recognize taxable market discount income when we receive the proceeds from the disposition of, or principal payments on, loans that have a stated redemption price at maturity that

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## **Table of Contents**

is greater than our tax basis in those loans, although such proceeds often will be used to make non-deductible principal payments on related borrowings.

We may recognize taxable income without receiving a corresponding cash distribution if we foreclose on or make a significant modification to a loan to the extent that the fair market value of the underlying property or the principal amount of the modified loan, as applicable, exceeds our basis in the original loan.

We may recognize phantom taxable income from any residual interests in REMICs or retained ownership interests in mortgage loans subject to collateralized mortgage obligation debt.

Although several types of non-cash income are excluded in determining the annual distribution requirement, we will incur corporate income tax and the 4% nondeductible excise tax with respect to those non-cash income items if we do not distribute those items on a current basis. As a result of the foregoing, we may have less cash than is necessary to distribute all of our taxable income and thereby avoid corporate income tax and the excise tax imposed on certain undistributed income. In such a situation, we may need to borrow funds or issue additional common stock or preferred stock.

Under certain circumstances, we may be able to correct a failure to meet the distribution requirement for a year by paying deficiency dividends to our stockholders in a later year. We may include such deficiency dividends in our deduction for dividends paid for the earlier year. Although we may be able to avoid income tax on amounts distributed as deficiency dividends, we will be required to pay interest to the IRS based upon the amount of any deduction we take for deficiency dividends.

The IRS has provided temporary assistance to REITs that wish to preserve cash, but that also must meet their minimum distribution requirements. Under certain circumstances, the distribution requirements can be met through a distribution of the REIT's own stock. We have not declared such a distribution and do not anticipate doing so.

## **Recordkeeping Requirements**

We must maintain certain records in order to qualify as a REIT. In addition, to avoid a monetary penalty, we must request, on an annual basis, information from our stockholders designed to disclose the actual ownership of our outstanding stock. We intend to comply with these requirements.

## **Failure to Qualify**

If we fail to satisfy one or more requirements for REIT qualification, other than the gross income tests and the asset tests, we could avoid disqualification if our failure is due to reasonable cause and not to willful neglect and we pay a penalty of \$50,000 for each such failure. In addition, there are relief provisions for a failure of the gross income tests and asset tests as described in *Income Tests* and *Asset Tests*.

If we fail to qualify as a REIT in any taxable year and no relief provision applies, we would be subject to federal income tax and any applicable alternative minimum tax on our taxable income at regular corporate rates. In calculating our taxable income in a year in which we fail to qualify as a REIT, we would not be able to deduct amounts paid out to stockholders. In fact, we would not be required to distribute any amounts to stockholders in that year. In such event, to the extent of our current and accumulated earnings and profits, all distributions to stockholders would be taxable as ordinary income. Subject to certain limitations of the federal income tax laws, corporate stockholders might be eligible for the dividends received deduction and domestic non-corporate stockholders may be eligible for the reduced federal income tax rate of 20% on qualified dividends. Unless we qualified for relief under specific statutory provisions, we also would be disqualified from taxation as a REIT for the four taxable years following the year during which we ceased to qualify as a REIT. We cannot predict whether, in all circumstances, we would qualify for such statutory relief.

## **Table of Contents**

### **Qualified REIT Subsidiaries**

A qualified REIT subsidiary is any corporation in which we own 100% of such corporation's outstanding stock and for which no election has been made to classify it as a taxable REIT subsidiary. As such, their assets, liabilities and income would generally be treated as our assets, liabilities and income for purposes of each of the above REIT qualification tests. We currently have no qualified REIT subsidiaries.

### **Taxable REIT Subsidiaries**

A taxable REIT subsidiary is any corporation in which we own stock (directly or indirectly) and which we and such corporation elect to classify as a taxable REIT subsidiary. A taxable REIT subsidiary is not subject to the REIT asset, income and distribution requirements, nor are its assets, liabilities or income treated as our assets, liabilities or income for purposes of each of the above REIT qualification tests. We currently have no taxable REIT subsidiaries. We generally intend to make a taxable REIT subsidiary election with respect to any other corporation in which we acquire securities constituting more than 10% by vote or value of such corporation and that is not a qualified REIT subsidiary. However, the aggregate value of all of our taxable REIT subsidiaries must be limited to 25% of the total value of our assets.

We will be subject to a 100% penalty tax on any rent, interest or other charges that we impose on any taxable REIT subsidiary in excess of an arm's length price for comparable services. We expect that any rents, interest or other charges imposed on any taxable REIT subsidiary will be at arm's length prices.

We generally expect to derive income from our taxable REIT subsidiaries by way of dividends in the event that we establish any taxable REIT subsidiaries. Such dividends are not real estate source income for purposes of the 75% income test, although they are included for purposes of the 95% test. Therefore, when aggregated with our non-real estate source income, such dividends must be limited to 25% of our gross income each year. We will monitor the value of our investment in, and the distributions from, our taxable REIT subsidiaries to ensure compliance with all applicable REIT income and asset tests in the event that we establish any taxable REIT subsidiaries.

Taxable REIT subsidiaries are generally subject to corporate level tax on their net income and will generally be able to distribute only net after-tax earnings to its stockholders, including us, as dividend distributions. Dividends sourced from dividends received from taxable REIT subsidiaries (if any) can qualify for the 20% tax rate on qualified dividends. We currently have no taxable REIT subsidiaries.

### **Taxation of Taxable U.S. Stockholders**

For purposes of the discussion in this prospectus, the term "U.S. stockholder" or "U.S. warrant holder" means a holder of our stock or warrants, as applicable, that is, for U.S. federal income tax purposes:

a citizen or resident of the U.S.;

a corporation (including an entity treated as a corporation for federal income tax purposes), partnership or other entity created or organized in or under the laws of the U.S. or of any state thereof or in the District of Columbia, unless Treasury regulations provide otherwise;

an estate the income of which is subject to U.S. federal income taxation regardless of its source; or

a trust (i) whose administration is subject to the primary supervision of a U.S. court and which has one or more U.S. persons who have the authority to control all substantial decisions of the trust or (ii) that has a valid election in place to be treated as a U.S. person.

### ***Distributions Generally***

Distributions out of our current or accumulated earnings and profits, other than capital gain dividends, will generally be taxable to U.S. stockholders as ordinary income. Provided that we continue to qualify as a REIT,



## **Table of Contents**

dividends paid by us will not be eligible for the dividends received deduction generally available to U.S. stockholders that are corporations. To the extent that we make distributions in excess of current and accumulated earnings and profits, the distributions will be treated as a tax-free return of capital to each U.S. stockholder and will reduce the adjusted tax basis which each U.S. stockholder has in our stock by the amount of the distribution, but not below zero. Distributions in excess of a U.S. stockholder's adjusted tax basis in its stock will be taxable as capital gain and will be taxable as long-term capital gain if the stock has been held for more than one year. If we declare a dividend in October, November, or December of any calendar year which is payable to stockholders of record on a specified date in such a month and actually pay the dividend during January of the following calendar year, the dividend is deemed to be paid by us and received by the stockholder on December 31st of the previous year, but only to the extent we have any remaining undistributed earnings and profits (as computed under the Code) as of December 31st. Any portion of this distribution in excess of our previously undistributed earnings and profits as of December 31st should be treated as a distribution to our stockholders in the following calendar year for U.S. federal income tax purposes. Stockholders may not include in their own income tax returns any of our net operating losses or capital losses. Ordinary dividends to a U.S. stockholder generally will not qualify for the 20% tax rate for qualified dividend income. However, the 20% tax rate for qualified dividend income will apply to our ordinary REIT dividends (i) attributable to dividends received by us from non-REIT corporations such as a taxable REIT subsidiary, and (ii) any income on which we have paid a corporate income tax.

### *Cost Basis Reporting*

New federal income tax information reporting rules may apply to certain transactions in our shares acquired through the Dividend Reinvestment and Stock Purchase Plan. Where such rules apply, the cost basis calculated for the shares involved will be reported to the IRS and to you. Generally these rules apply to all shares purchased after December 31, 2010 including those purchased through the Dividend Reinvestment and Stock Purchase Plan. For cost basis reporting purposes, you may identify by lot the shares that you transfer or that are redeemed, but if you do not timely notify us of your election, we will identify the shares that are transferred or redeemed on a first in/first out basis. The shares in the Dividend Reinvestment and Stock Purchase Plan are also eligible for the average cost basis method, should you so elect.

Information reporting (transfer statements) on other transactions may also be required under these new tax rules. Generally, these reports are made for certain transactions other than purchases in shares acquired before January 1, 2011. Transfer statements are issued between brokers and are not issued to the IRS or to you.

Stockholders should consult their tax advisors regarding the consequences to of these new tax rules.

### *Capital Gain Distributions*

Distributions designated by us as capital gain dividends will be taxable to U.S. stockholders as capital gain income. We can designate distributions as capital gain dividends to the extent of our net capital gain for the taxable year of the distribution. This capital gain income will generally be taxable to non-corporate U.S. stockholders at a 20% or 25% rate based on the characteristics of the asset we sold that produced the gain. U.S. stockholders that are corporations may be required to treat up to 20% of certain capital gain dividends as ordinary income.

### *Retention of Net Capital Gains*

We may elect to retain, rather than distribute as a capital gain dividend, our net capital gains. If we were to make this election, we would pay tax on such retained capital gains. In such a case, our stockholders would generally:

include their proportionate share of our undistributed net capital gains in their taxable income;

## **Table of Contents**

receive a credit for their proportionate share of the tax paid by us in respect of such net capital gain; and

increase the adjusted basis of their stock by the difference between the amount of their share of our undistributed net capital gain and their share of the tax paid by us.

### *Passive Activity Losses, Investment Interest Limitations and Other Considerations of Holding Our Stock*

Distributions we make and gains arising from the sale or exchange of our stock by a U.S. stockholder will not be treated as passive activity income. As a result, U.S. stockholders will not be able to apply any passive losses against income or gains relating to our stock. Distributions by us, to the extent they do not constitute a return of capital, generally will be treated as investment income for purposes of computing the investment interest limitation under the Code. Further, if we, or a portion of our assets, were to be treated as a taxable mortgage pool, any excess inclusion income that is allocated to you could not be offset by any losses or other deductions you may have.

### *Dispositions of Stock or Warrants*

A U.S. stockholder or U.S. warrant holder that sells or disposes of our stock or warrants will recognize gain or loss for federal income tax purposes in an amount equal to the difference between the amount of cash or the fair market value of any property the stockholder or warrant holder receives on the sale or other disposition and the stockholder's or warrant holder's adjusted tax basis in the stock or warrants, as applicable. This gain or loss will be capital gain or loss and will be long-term capital gain or loss if the stockholder or warrant holder has held the stock or warrants for more than one year. In general, any loss recognized by a U.S. stockholder or warrant holder upon the sale or other disposition of our stock or warrants that the stockholder or warrant holder has held for six months or less will be treated as long-term capital loss to the extent the stockholder or warrant holder received distributions from us which were required to be treated as long-term capital gains. All or a portion of any loss that a U.S. stockholder or warrant holder realizes upon a taxable disposition of our stock may be disallowed if the stockholder purchases other stock within 30 days before or after the disposition.

### *Information Reporting and Backup Withholding*

We report to our U.S. stockholders and the IRS the amount of dividends paid during each calendar year and the amount of any tax withheld. Under the backup withholding rules, a stockholder may be subject to backup withholding with respect to dividends paid and redemption proceeds unless the holder is a corporation or comes within other exempt categories and, when required, demonstrates this fact or provides a taxpayer identification number or social security number certifying as to no loss of exemption from backup withholding and otherwise complies with applicable requirements of the backup withholding rules. A U.S. stockholder that does not provide us with its correct taxpayer identification number or social security number may also be subject to penalties imposed by the IRS. A U.S. stockholder can meet this requirement by providing us with a correct, properly completed and executed copy of IRS Form W-9 or a substantially similar form. Backup withholding is not an additional tax. Any amount paid as backup withholding will be creditable against the stockholder's income tax liability, if any, and otherwise be refundable. In addition, we may be required to withhold a portion of capital gain distributions made to any stockholders who fail to certify their non-foreign status.

### **Taxation of Tax-Exempt Stockholders and Warrant Holders**

The IRS has ruled that amounts distributed as a dividend by a REIT will be treated as a dividend by the recipient and excluded from the calculation of unrelated business taxable income, or UBTI, when received by a tax-exempt entity. Based on that ruling, provided that a tax-exempt stockholder has not held our stock as debt financed property within the meaning of the Code, i.e., property, the acquisition, or holding of which is financed through a borrowing by the tax-exempt U.S. stockholder, the stock is not otherwise used in an unrelated trade or business, and we do not hold a residual interest in a REMIC that gives rise to excess inclusion income, as



## **Table of Contents**

defined in Section 860E of the Code, dividend income on our stock and income from the sale of our stock should not be unrelated business taxable income to a tax-exempt stockholder. However, if we or a pool of our assets were to be treated as a taxable mortgage pool, a portion of the dividends paid to a tax-exempt stockholder may be subject to tax as unrelated business taxable income. Although we do not believe that we, or any portion of our assets, will be treated as a taxable mortgage pool, no assurance can be given that the IRS might not successfully maintain that such a taxable mortgage pool exists.

For tax-exempt stockholders that are social clubs, voluntary employee benefit associations, supplemental unemployment benefit trusts, and qualified group legal services plans exempt from federal income taxation under Sections 501(c)(7), (c)(9), (c)(17) and (c)(20) of the Code, respectively, income from an investment in our stock will constitute unrelated business taxable income unless the organization is able to properly claim a deduction for amounts set aside or placed in reserve for certain purposes so as to offset the income generated by its investment in our stock. Any prospective and current investors should consult their tax advisors concerning these set aside and reserve requirements.

Notwithstanding the above, however, a substantial portion of the dividends a tax-exempt stockholder receives may constitute UBTI if we are treated as a pension-held REIT and the stockholder is a pension trust which:

is described in Section 401(a) of the Code; and

holds more than 10%, by value, of the interests in the REIT.

Tax-exempt pension funds that are described in Section 401(a) of the Code and exempt from tax under Section 501(a) of the Code are referred to below as qualified trusts.

A REIT is a pension-held REIT if:

it would not have qualified as a REIT but for the fact that Section 856(h)(3) of the Code provides that stock owned by a qualified trust shall be treated, for purposes of the 5/50 Rule, described above, as owned by the beneficiaries of the trust, rather than by the trust itself; and

either at least one qualified trust holds more than 25%, by value, of the interests in the REIT, or one or more qualified trusts, each of which owns more than 10%, by value, of the interests in the REIT, holds in the aggregate more than 50%, by value, of the interests in the REIT.

The percentage of any REIT dividend treated as unrelated business taxable income is equal to the ratio of:

the unrelated business taxable income earned by the REIT, less directly related expenses, treating the REIT as if it were a qualified trust and therefore subject to tax on unrelated business taxable income, to

the total gross income, less directly related expenses, of the REIT.

A de minimis exception applies where the percentage is less than 5% for any year. As a result of the limitations on the transfer and ownership of stock contained in our charter, we do not expect to be classified as a pension-held REIT.

## **Taxation of Non-U.S. Stockholders**

The rules governing federal income taxation of non-U.S. stockholders are complex and no attempt will be made herein to provide more than a summary of these rules. Non-U.S. stockholders means beneficial owners of shares of our stock that are not U.S. stockholders (as such term is defined in the discussion above under the heading entitled Taxation of Taxable U.S. Stockholders).



## **Table of Contents**

### **PROSPECTIVE AND CURRENT NON-U.S. STOCKHOLDERS SHOULD CONSULT THEIR TAX ADVISORS TO DETERMINE THE IMPACT OF FOREIGN, FEDERAL, STATE AND LOCAL INCOME TAX LAWS WITH REGARD TO AN INVESTMENT IN OUR STOCK AND OF OUR ELECTION TO BE TAXED AS A REAL ESTATE INVESTMENT TRUST, INCLUDING ANY REPORTING REQUIREMENTS.**

Distributions to non-U.S. stockholders that are not attributable to gain from our sale or exchange of U.S. real property interests, and that are not designated by us as capital gain dividends or retained capital gains, will be treated as dividends of ordinary income to the extent that they are made out of our current or accumulated earnings and profits. These distributions will generally be subject to a withholding tax equal to 30% of the distribution unless an applicable tax treaty reduces or eliminates that tax. However, if income from an investment in our stock is treated as effectively connected with the non-U.S. stockholder's conduct of a U.S. trade or business, the non-U.S. stockholder generally will be subject to federal income tax at graduated rates on a net basis in the same manner as U.S. stockholders are taxed with respect to those distributions and also may be subject to the 30% branch profits tax in the case of a non-U.S. stockholder that is a corporation. We expect to withhold tax at the rate of 30% on the gross amount of any distributions made to a non-U.S. stockholder unless:

a lower treaty rate applies and any required form, for example IRS Form W-8BEN, evidencing eligibility for that reduced rate is filed by the non-U.S. stockholder with us; or

the non-U.S. stockholder files an IRS Form W-8ECI with us claiming that the distribution is effectively connected income. Any portion of the dividends paid to non-U.S. stockholders that is treated as excess inclusion income will not be eligible for exemption from the 30% withholding tax or a reduced treaty rate.

Distributions in excess of our current and accumulated earnings and profits will not be taxable to non-U.S. stockholders to the extent that these distributions do not exceed the adjusted basis of the stockholder's stock, but rather will reduce the adjusted basis of that stock. To the extent that distributions in excess of current and accumulated earnings and profits exceed the adjusted basis of a non-U.S. stockholder's stock, these distributions will give rise to tax liability if the non-U.S. stockholder would otherwise be subject to tax on any gain from the sale or disposition of its stock, as described below. Because it generally cannot be determined at the time a distribution is made whether or not such distribution may be in excess of current and accumulated earnings and profits, the entire amount of any distribution normally will be subject to withholding at the same rate as a dividend. However, amounts so withheld are creditable against U.S. tax liability, if any, or refundable by the IRS to the extent the distribution is subsequently determined to be in excess of our current and accumulated earnings and profits. We are also required to withhold 10% of any distribution in excess of our current and accumulated earnings and profits if our stock is a U.S. real property interest and if we are not a domestically controlled REIT, as discussed below. Consequently, although we intend to withhold at a rate of 30% on the entire amount of any distribution, to the extent that we do not do so, any portion of a distribution not subject to withholding at a rate of 30% may be subject to withholding at a rate of 10%.

Distributions attributable to our capital gains which are not attributable to gain from the sale or exchange of a U.S. real property interest generally will not be subject to income taxation unless (1) investment in our stock is effectively connected with the non-U.S. stockholder's U.S. trade or business (or, if an income tax treaty applies, is attributable to a U.S. permanent establishment of the non-U.S. stockholder), in which case the non-U.S. stockholder will be subject to the same treatment as U.S. stockholders with respect to such gain (except that a corporate non-U.S. stockholder may also be subject to the 30% branch profits tax), or (2) the non-U.S. stockholder is a non-resident alien individual who is present in the U.S. for 183 days or more during the taxable year and certain other conditions are satisfied, in which case the non-resident alien individual will be subject to a 30% tax on the individual's capital gains.

For any year in which we qualify as a REIT, distributions that are attributable to gain from the sale or exchange of a U.S. real property interest, which includes some interests in real property, but generally does not

## **Table of Contents**

include an interest solely as a creditor in mortgage loans or MBS, will be taxed to a non-U.S. stockholder under the provisions of the Foreign Investment in Real Property Tax Act of 1980, or FIRPTA. Under FIRPTA, distributions attributable to gain from sales of U.S. real property interests are taxed to a non-U.S. stockholder as if that gain were effectively connected with the stockholder's conduct of a U.S. trade or business. Non-U.S. stockholders thus would be taxed at the normal capital gain rates applicable to stockholders, subject to applicable alternative minimum tax and a special alternative minimum tax in the case of nonresident alien individuals. Distributions subject to FIRPTA also may be subject to the 30% branch profits tax in the hands of a non-U.S. corporate stockholder. We are required to withhold 35% of any distribution that we designate (or, if greater, the amount that we could designate) as a capital gains dividend. The amount withheld is creditable against the non-U.S. stockholder's FIRPTA tax liability.

A capital gain distribution from a REIT to a foreign investor has been removed from the category of effectively connected income, provided that (i) the distribution is received with respect to a class of stock that is regularly traded on an established securities market located in the U.S. (our stock currently is so traded) and (ii) the foreign investor does not own more than 5% of the class of stock at any time during the taxable year within which the distribution is received. In that case, the foreign investor is not required to file a U.S. federal income tax return by reason of receiving such a distribution. The distribution is to be treated as a REIT dividend to that investor, taxed as a REIT dividend that is not a capital gain. Also, the branch profits tax does not apply to such a distribution.

Gains recognized by a non-U.S. stockholder upon a sale of our stock generally will not be taxed under FIRPTA if we are a domestically-controlled REIT, which is a REIT in which at all times during a specified testing period less than 50% in value of the stock was held directly or indirectly by non-U.S. stockholders. Because our stock is publicly traded, we cannot assure our investors that we are or will remain a domestically-controlled REIT. Even if we are not a domestically-controlled REIT, however, a non-U.S. stockholder that owns, actually or constructively, 5% or less of our stock throughout a specified testing period will not recognize taxable gain on the sale of our stock under FIRPTA if the shares are traded on an established securities market.

If gain from the sale of the stock were subject to taxation under FIRPTA, the non-U.S. stockholder would be subject to the same treatment as U.S. stockholders with respect to that gain, subject to applicable alternative minimum tax, a special alternative minimum tax in the case of nonresident alien individuals, and the possible application of the 30% branch profits tax in the case of non-U.S. corporations. In addition, the purchaser of the stock could be required to withhold 10% of the purchase price and remit such amount to the IRS.

Gains not subject to FIRPTA will be taxable to a non-U.S. stockholder if:

the non-U.S. stockholder's investment in the stock is effectively connected with a trade or business in the U.S., in which case the non-U.S. stockholder will be subject to the same treatment as U.S. stockholders with respect to that gain; or

the non-U.S. stockholder is a nonresident alien individual who was present in the U.S. for 183 days or more during the taxable year and other conditions are met, in which case the nonresident alien individual will be subject to a 30% tax on the individual's capital gains.

### *Information Reporting and Backup Withholding*

If the proceeds of a disposition of our stock are paid by or through a U.S. office of a broker-dealer, the payment is generally subject to information reporting and to backup withholding (currently at a rate of 28%) unless the disposing non-U.S. stockholder certifies as to his name, address and non-U.S. status or otherwise establishes an exemption. Generally, U.S. information reporting and backup withholding will not apply to a payment of disposition proceeds if the payment is made outside the U.S. through a foreign office of a foreign broker-dealer. If the proceeds from a disposition of our stock are paid to or through a foreign office of a U.S. broker-dealer or a non-U.S. office of a foreign broker-dealer that is (i) a controlled foreign corporation for federal income tax purposes, (ii) a foreign person 50% or more of whose gross income from all sources for a

## **Table of Contents**

three-year period was effectively connected with a U.S. trade or business, (iii) a foreign partnership with one or more partners who are U.S. persons and who in the aggregate hold more than 50% of the income or capital interest in the partnership, or (iv) a foreign partnership engaged in the conduct of a trade or business in the U.S., then (i) backup withholding will not apply unless the broker-dealer has actual knowledge that the owner is not a foreign stockholder, and (ii) information reporting will not apply if the non-U.S. stockholder satisfies certification requirements regarding its status as a foreign stockholder.

### **Recently Enacted Withholding Legislation**

Shareholders that acquire stock in the Company through an account maintained at a non-U.S. financial institution should be aware that the Foreign Account Tax Compliance Act ( FATCA ), enacted in 2010 provides that a 30% withholding tax will be imposed on certain payments made to a foreign entity if such entity fails to satisfy certain new disclosure and reporting rules. FATCA generally requires that (i) in the case of shareholder that is foreign financial institution (defined broadly to include a hedge fund, a private equity fund, a mutual fund, a securitization vehicle or other investment vehicle), the entity identifies and provides information in respect of financial accounts with such entity held (directly or indirectly) by U.S. persons and U.S.-owned foreign entities and (ii) in the case of a shareholder that is a non-financial foreign entity, the entity identifies and provides information in respect of substantial U.S. owners of such entity.

The IRS has released final regulations generally providing that FATCA withholding will not apply with respect to payments made prior to January 1, 2014 and that FATCA withholding tax on gross proceeds from the disposition of stock will not be imposed with respect to payments made prior to January 1, 2017. The United States Treasury is also in the process of signing Intergovernmental Agreements with other countries to implement the exchange of information required under FATCA. Shareholders that invest in the Company through an account maintained at a non-U.S. financial institution are strongly encouraged to consult with their own tax advisors regarding the potential application and impact of FATCA and any Intergovernmental Agreement between the United States and their home jurisdiction in connection with FATCA compliance.

### **State, Local and Foreign Taxation**

We may be required to pay state, local and foreign taxes in various state, local and foreign jurisdictions, including those in which we transact business or make investments, and our stockholders may be required to pay state, local and foreign taxes in various state, local and foreign jurisdictions, including those in which they reside. Our state, local and foreign tax treatment may not conform to the federal income tax consequences summarized above. In addition, a stockholder's state, local and foreign tax treatment may not conform to the federal income tax consequences summarized above. Consequently, prospective investors should consult their tax advisors regarding the effect of state, local and foreign tax laws on an investment in our stock.

### **Possible Legislative or Other Actions Affecting Tax Considerations**

Prospective investors and stockholders should recognize that the present U.S. federal income tax treatment of an investment in our stock or warrants may be modified by legislative, judicial or administrative action at any time and that any such action may affect investments and commitments previously made. The rules dealing with U.S. federal income taxation are constantly under review by persons involved in the legislative process and by the IRS and the U.S. Treasury Department, resulting in revisions of regulations and revised interpretations of established concepts as well as statutory changes. Revisions in U.S. federal tax laws and interpretations thereof could adversely affect the tax consequences of an investment in our stock or warrants.

## **PLAN OF DISTRIBUTION**

We may sell the securities offered pursuant to this prospectus and any accompanying prospectus supplements to or through one or more underwriters or dealers, or we may sell the securities to investors directly

## **Table of Contents**

or through agents. Each prospectus supplement will describe the number and terms of the securities to which such prospectus supplement relates, the name or names of any underwriters or agents with whom we have entered into arrangements with respect to the sale of such securities, the public offering or purchase price of such securities, and the net proceeds we will receive from such sale. Any underwriter or agent involved in the offer and sale of the securities will be named in the applicable prospectus supplement, if any. We may sell securities directly to investors on our own behalf in those jurisdictions where we are authorized to do so.

Underwriters may offer and sell the securities at a fixed price or prices, which may be changed, at market prices prevailing at the time of sale, at prices related to the prevailing market prices or at negotiated prices. We also may, from time to time, authorize dealers or agents to offer and sell these securities upon such terms and conditions as may be set forth in the applicable prospectus supplement. In connection with the sale of any of these securities, underwriters may receive compensation from us in the form of underwriting discounts or commissions and may also receive commissions from purchasers of the securities for whom they may act as agent. Underwriters may sell the securities to or through dealers, and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters or commissions from the purchasers for which they may act as agents.

Shares may also be sold in one or more of the following transactions: (i) block transactions (which may involve crosses) in which a broker-dealer may sell all or a portion of the shares as agent but may position and resell all or a portion of the block as principal to facilitate the transaction; (ii) purchases by a broker-dealer as principal and resale by the broker-dealer for its own account pursuant to a prospectus supplement; (iii) a special offering, an exchange distribution or a secondary distribution in accordance with applicable New York Stock Exchange or other stock exchange rules; (iv) ordinary brokerage transactions and transactions in which a broker-dealer solicits purchasers; (v) sales at the market to or through a market maker or into an existing trading market, on an exchange or otherwise, for shares; and (vi) sales in other ways not involving market makers or established trading markets, including direct sales to purchasers. Broker-dealers may also receive compensation from purchasers of the shares which is not expected to exceed that customary in the types of transactions involved.

Any underwriting compensation paid by us to underwriters or agents in connection with the offering of these securities, and any discounts or concessions or commissions allowed by underwriters to participating dealers, will be set forth in the applicable prospectus supplement. Dealers and agents participating in the distribution of the securities may be deemed to be underwriters, and any discounts and commissions received by them and any profit realized by them on resale of the securities may be deemed to be underwriting discounts and commissions.

Underwriters, dealers and agents may be entitled, under agreements entered into with us, to indemnification against and contribution toward certain civil liabilities, including liabilities under the Securities Act of 1933, as amended. Unless otherwise set forth in the accompanying prospectus supplement, the obligations of any underwriters to purchase any of these securities will be subject to certain conditions precedent, and the underwriters will be obligated to purchase all of the series of securities, if any are purchased. Any offers made pursuant to our sales agreement with Cantor Fitzgerald & Co., however, will not obligate Cantor Fitzgerald & Co., as sales manager, to purchase all of the securities so offered.

Underwriters, dealers and agents may engage in transactions with, or perform services for, us and our affiliates in the ordinary course of business.

In connection with offering securities pursuant to this prospectus, certain underwriters, and selling group members and their respective affiliates, may engage in transactions that stabilize, maintain or otherwise affect the market price of the applicable securities. These transactions may include stabilization transactions effected in accordance with Rule 104 of Regulation M promulgated by the SEC pursuant to which these persons may bid for or purchase securities for the purpose of stabilizing their market price.

## **Table of Contents**

The underwriters in an offering of securities may also create a short position for their account by selling more securities in connection with the offering than they are committed to purchase from us. In that case, the underwriters could cover all or a portion of the short position by either purchasing securities in the open market following completion of the offering of these securities or by exercising any over-allotment option granted to them by us. In addition, the managing underwriter may impose penalty bids under contractual arrangements with other underwriters, which means that they can reclaim from an underwriter (or any selling group member participating in the offering) for the account of the other underwriters, the selling concession for the securities that are distributed in the offering but subsequently purchased for the account of the underwriters in the open market. Any of the transactions described in this paragraph or comparable transactions that are described in any accompanying prospectus supplement may result in the maintenance of the price of the securities at a level above that which might otherwise prevail in the open market. None of the transactions described in this paragraph or in an accompanying prospectus supplement are required to be taken by any underwriters and, if they are undertaken, may be discontinued at any time.

Our common stock is listed on the New York Stock Exchange under the symbol ANH. Our 8.625% Series A Cumulative Preferred Stock, referred to as our Series A Preferred Stock, is listed on the New York Stock Exchange under the symbol ANHPRA. Our 6.25% Series B Cumulative Convertible Preferred Stock, referred to as our Series B Preferred Stock, is listed on the New York Stock Exchange under the symbol ANHPRB. All other series of our preferred stock other than our Series A Preferred Stock and our Series B Preferred Stock will be new issues of securities with no established trading market and may or may not be listed on a national securities exchange. Any underwriters or agents to or through which securities are sold by us may make a market in the securities, but these underwriters or agents will not be obligated to do so and any of them may discontinue any market making at any time without notice. No assurance can be given as to the liquidity of or trading market for any securities sold by us.

## **EXPERTS**

The financial statements of Anworth Mortgage Asset Corporation as of December 31, 2012 and 2011 and for each of the years in the three year period ended December 31, 2012 have been incorporated by reference in this prospectus in reliance upon the report of McGladrey LLP, independent registered public accounting firm, incorporated by reference herein, and upon such reports given upon the authority of said firm as experts in auditing and accounting.

Management's report on the effectiveness of internal control over financial reporting of Anworth Mortgage Asset Corporation as of December 31, 2012 and for the year ended December 31, 2012 have been incorporated by reference in this prospectus in reliance upon the report of McGladrey LLP, an independent registered public accounting firm, incorporated by reference herein, and upon such reports given upon the authority of said firm as experts in auditing and accounting.

## **LEGAL MATTERS**

Certain tax matters will be passed upon for us by Greenberg Traurig, LLP, Los Angeles, California. Selected legal matters related to Maryland law, including the validity of our securities offered in this prospectus, will be passed upon for us by DLA Piper LLP (US), Baltimore, Maryland.

## **INFORMATION INCORPORATED BY REFERENCE**

The SEC allows us to incorporate by reference the information that we file with the SEC. This means that we can disclose important information to you by referring you to another document filed separately with the SEC

## **Table of Contents**

under the Securities Exchange Act of 1934, as amended, or the Exchange Act. The information incorporated by reference is deemed to be part of this prospectus, except for any information superseded by information in this prospectus. We have filed with the SEC and incorporate by reference:

our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 filed on February 27, 2013, including portions of our Definitive Proxy Statement on Schedule 14A filed on March 25, 2013 to the extent specifically incorporated by reference therein;

our Current Report on Form 8-K filed on March 28, 2013;

our Current Report on Form 8-K/A filed on January 22, 2013;

the description of our common stock included in our registration statement on Form 8-A filed on April 30, 2003;

the description of our Series A Cumulative Preferred Stock included in our registration statement on Form 8-A filed on November 3, 2004; and

the description of our Series B Cumulative Convertible Preferred Stock included in our registration statement on Form 8-A filed on January 30, 2007.

Any documents we file pursuant to Section 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of filing of the registration statement and prior to the effectiveness of the registration statement and any documents we file pursuant to Section 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this prospectus and prior to the termination of the offering of the securities to which this prospectus relates will automatically be deemed to be incorporated by reference in this prospectus and to be part hereof from the date of filing those documents. Any statement contained in this prospectus or in a document incorporated by reference shall be deemed to be modified or superseded for all purposes to the extent that a statement contained in this prospectus or in any other document which is also incorporated by reference modifies or supersedes that statement.

We will provide without charge to each person to whom a copy of this prospectus is delivered, upon such person's written or oral request, a copy of any and all of the information incorporated by reference in this prospectus, other than exhibits to such documents, unless such exhibits are specifically incorporated by reference into the information that this prospectus incorporates. Requests should be directed to the Secretary at Anworth Mortgage Asset Corporation, 1299 Ocean Avenue, Second Floor, Santa Monica, CA 90401, telephone: (310) 255-4493.

## **WHERE YOU CAN FIND MORE INFORMATION**

We file annual, quarterly and special reports, proxy statements and other information with the SEC. You may read and copy the materials we file at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Rooms. Our SEC filings are also available to the public from the SEC's World Wide Web site on the Internet at <http://www.sec.gov>. This site contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. You may also read and copy this information at the Financial Industry Regulatory Authority, Inc., 1735 K Street, N.W., Washington, D.C. 20006.

We maintain a site on the Internet at <http://www.anworth.com>. The information contained in our website is not part of this prospectus and you should not rely on it in deciding whether to invest in our securities.

We have filed a registration statement, of which this prospectus is a part, covering the offered securities. As allowed by SEC rules, this prospectus does not include all of the information contained in the registration statement and the included exhibits, financial statements and schedules. We refer you to the registration statement, the included exhibits, financial statements and schedules for further information. This prospectus is qualified in its entirety by such other information.





**Table of Contents**

**Shares**

**Anworth Mortgage Asset Corporation**

**7.625% Series C Cumulative Redeemable Preferred Stock**

**PROSPECTUS SUPPLEMENT**

***Joint Book-Running Managers***

**MLV & Co.**

**JMP Securities**

***Co-Managers***

**Ladenburg Thalmann**

**Maxim Group LLC**

**January , 2015**