NEW YORK MORTGAGE TRUST INC
Form 10-Q
May 05, 2011
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2011

OR

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

For the transition period from _______ to ____________

Commission file number 001-32216

NEW YORK MORTGAGE TRUST, INC.
(Exact Name of Registrant as Specified in Its Charter)

Maryland	47-0934168
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

52 Vanderbilt Avenue, Suite 403, New York, New York 10017
(Address of Principal Executive Office) (Zip Code)

(212) 792-0107
(Registrant’s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes o No o

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

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer o Smaller Reporting Company x

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

The number of shares of the registrant’s common stock, par value $.01 per share, outstanding on May 4, 2011 was 9,442,537.

NEW YORK MORTGAGE TRUST, INC.

FORM 10-Q

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (unaudited)

NEW YORK MORTGAGE TRUST, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(amounts in thousands, except share and per share amounts)

ASSETS	March 31, 2011 (unaudited)	December 31, 2010
Investment securities available for sale, at fair value (including pledged securities of $55,772 and $38,475, respectively)	$119,322	$86,040
Mortgage loans held in securitization trusts (net)	223,271	228,185
Mortgage loans held for investment	2,590	7,460
Investment in limited partnership	16,649	18,665
Cash and cash equivalents	8,436	19,375
Restricted cash	10,264	-
Receivable under reverse repurchase agreements	40,252	-
Receivable for securities sold	45,750	5,653
Derivative asset	5,902	-
Receivables and other assets	9,781	8,916
Total Assets	$482,217	$374,294
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Financing arrangements, portfolio investments	$46,563	$35,632
Securities sold short, at fair value	81,918	-
Collateralized debt obligations	215,260	219,993
Derivative liabilities	827	1,087
Payable for securities purchased	17,450	-
Accrued expenses and other liabilities	3,988	4,095
Subordinated debentures (net)	45,000	45,000
Total liabilities	411,006	305,807
Commitments and Contingencies		
Stockholders' Equity:		
Common stock, $0.01 par value, 400,000,000 authorized, 9,442,537 and 9,425,442, shares issued and outstanding, respectively	94	94
Additional paid-in capital	133,668	135,300
Accumulated other comprehensive income	19,574	17,732
Accumulated deficit	(82,125)	(84,639)
Total stockholders' equity	71,211	68,487
Total Liabilities and Stockholders' Equity	$482,217	$374,294

See notes to condensed consolidated financial statements.

NEW YORK MORTGAGE TRUST, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(amounts in thousands, except per share amounts)
(unaudited)

	For the Three Months Ended March 31, 2011	2010
INTEREST INCOME	$3,694	$6,221
INTEREST EXPENSE:		
Investment securities and loans held in securitization trusts	718	1,392
Subordinated debentures	466	759
Convertible preferred debentures	-	662
Total interest expense	1,184	2,813
NET INTEREST INCOME	2,510	3,408
OTHER INCOME (EXPENSE):		
Provision for loan losses	(633)	(2)
Income from investment in limited partnership	784	-
Realized gain on investment securities and related hedges	2,191	807
Unrealized loss on investment securities and related hedges	(40)	-
Total other income (expense)	2,302	805
General, administrative and other expenses	2,293	1,856
INCOME FROM CONTINUING OPERATIONS	2,519	2,357
(Loss) income from discontinued operation - net of tax	(5)	311
NET INCOME	$2,514	$2,668
Basic income per common share	$0.27	$0.28
Diluted income per common share	$0.27	$0.28
Dividends declared per common share	$0.18	$0.25
Weighted average shares outstanding-basic	9,433	9,418
Weighted average shares outstanding-diluted	9,433	11,918

See notes to condensed consolidated financial statements.

NEW YORK MORTGAGE TRUST, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(dollar amounts in thousands)
(unaudited)

	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income/(Loss)	Comprehensive Income	Total
Balance, December 31, 2010	$ 94	$ 135,300	$ (84,639)	$ 17,732	$ -	$ 68,487
Net income	-	-	2,514	-	2,514	2,514
Restricted stock issuance	-	68	-	-	-	68
Dividends declared	-	(1,700)	-	-	-	(1,700)
Reclassification adjustment for net gain included in net income	-	-	-	(1,868)	(1,868)	(1,868)
Increase in net unrealized gain on available for sale securities	-	-	-	3,450	3,450	3,450
Increase in fair value of derivative instruments utilized for cash flow hedges	-	-	-	260	260	260
Comprehensive income	-	-	-	-	$ 4,356	-
Balance, March 31, 2011	$ 94	$ 133,668	$ (82,125)	$ 19,574		$ 71,211

See notes to condensed consolidated financial statements.

NEW YORK MORTGAGE TRUST, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollar amounts in thousands)
(unaudited)

	For the Three Months Ended March 31, 2011	2010
Cash Flows from Operating Activities:		
Net income	$2,514	$2,668
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	34	320
Net accretion on investment securities and mortgage loans held in securitization trusts	(1,107)	(839)
Realized gain on securities and related hedges	(2,191)	(807)
Unrealized loss on securities and related hedges	40	-
Proceeds from repayments or sales of mortgage loans	7	8
Provision for loan losses	633	2
Income from investment in limited partnership	(784)	-
Distributions from investment in limited partnership	203	-
Restricted stock issuance	68	(48)
Changes in operating assets and liabilities:		
Receivables and other assets	(616)	(38)
Accrued expenses and other liabilities	(108)	(483)
Net cash (used in) provided by operating activities	(1,307)	783
Cash Flows from Investing Activities:		
Restricted cash	(10,745)	-
Purchases of reverse repurchase agreements	(40,252)	-
Purchases of investment securities	(30,399)	-
Proceeds from investment in limited partnership	2,597	-
Proceeds from mortgage loans held for investment	5,002	-
Proceeds from sales of investment securities	48,888	359
Principal repayments received on mortgage loans held in securitization trusts	4,453	16,776
Principal paydowns on investment securities - available for sale	6,340	8,982
Net cash (used in) provided by investing activities	(14,116)	26,117
Cash Flows from Financing Activities:		
Proceeds from (payments of) financing arrangements	10,931	(9,307)
Dividends paid	(1,697)	(2,355)
Payments made on collateralized debt obligations	(4,750)	(17,007)
Net cash provided by (used in) financing activities	4,484	(28,669)
Net Decrease in Cash and Cash Equivalents	(10,939)	(1,769)
Cash and Cash Equivalents - Beginning of Period	19,375	24,522
Cash and Cash Equivalents - End of Period	$8,436	$22,753
Supplemental Disclosure:		
Cash paid for interest	$1,113	$2,468

Non-Cash Investment Activities:		
Sale of investment securities not yet settled	$45,750	$2,936
Purchase of investment securities not yet settled	$17,450	$-
Non-Cash Financing Activities:		
Dividends declared to be paid in subsequent period	$1,700	$2,355

See notes to condensed consolidated financial statements.

NEW YORK MORTGAGE TRUST, INC. AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2011
(unaudited)

1. Summary of Significant Accounting Policies

Organization - New York Mortgage Trust, Inc., together with its consolidated subsidiaries (“NYMT,” the “Company,” “we,” “our” and “us”), is a real estate investment trust, or REIT, in the business of acquiring, investing in, financing and managing primarily mortgage-related assets. Our principal business objective is to generate net income for distribution to our stockholders resulting from the spread between the interest and other income we earn on our interest-earning assets and the interest expense we pay on the borrowings that we use to finance our leveraged assets and our operating costs, which we refer to as our net interest income. We intend to achieve this objective by investing in a broad class of mortgage-related and financial assets that in aggregate will generate what we believe are attractive risk-adjusted total returns for our stockholders. We also may opportunistically acquire and manage various other types of mortgage-related and financial assets that we believe will compensate us appropriately for the risks associated with them.

The Company conducts its business through the parent company, NYMT, and several subsidiaries, including special purpose subsidiaries established for loan securitization purposes, a taxable REIT subsidiary ("TRS") and a qualified REIT subsidiary ("QRS"). The Company conducts certain of its portfolio investment operations through its wholly-owned TRS, Hypotheca Capital, LLC (“HC”), in order to utilize, to the extent permitted by law, some or all of a net operating loss carry-forward held in HC that resulted from the Company's exit from the mortgage lending business. Prior to March 31, 2007, the Company conducted substantially all of its mortgage lending business through HC. The Company's wholly-owned QRS, New York Mortgage Funding, LLC (“NYMF”), currently holds certain mortgage-related assets for regulatory compliance purposes. The Company also may conduct certain other portfolio investment operations through NYMF. The Company consolidates all of its subsidiaries under generally accepted accounting principles in the United States of America (“GAAP”).

The Company is organized and conducts its operations to qualify as a REIT for federal income tax purposes. As such, the Company will generally not be subject to federal income tax on that portion of its income that is distributed to stockholders if it distributes at least 90% of its REIT taxable income to its stockholders by the due date of its federal income tax return and complies with various other requirements.

Basis of Presentation - The condensed consolidated balance sheet as of December 31, 2010, has been derived from audited financial statements. The condensed consolidated balance sheet at March 31, 2011, the condensed consolidated statements of operations for the three months ended March 31, 2011 and 2010, the condensed consolidated statement of stockholders’ equity for the three months ended March 31, 2011 and the condensed consolidated statements of cash flows for the three months ended March 31, 2011 and 2010 are unaudited. In our opinion, all adjustments (which include only normal recurring adjustments) necessary to present fairly the Company’s financial position, results of operations and cash flows have been made. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted in accordance with Article 10 of Regulation S-X and the instructions to Form 10-Q. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the Securities and Exchange Commission (“SEC”). The results of operations for the three months ended March 31, 2011 are not necessarily indicative of the operating results for the full year.

The accompanying condensed consolidated financial statements have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The condensed consolidated financial statements of the Company include the accounts of all subsidiaries; significant intercompany accounts and transactions have been eliminated.

Prior period income statement and balance sheet accounts have been reclassified to conform to current period classifications.

Investment Securities Available for Sale - The Company's investment securities, where the fair value option has not been elected and are reported at fair value with unrealized gains and losses reported in other comprehensive income ("OCI"), include residential mortgage-backed securities ("RMBS") that are issued by Fannie Mae, a federally chartered corporation ("GSE"), which, together with RMBS issued or guaranteed by other GSE's or government agencies, is referred to as "Agency RMBS," non-Agency RMBS and collateralized loan obligations ("CLOs"). Our investment securities are classified as available for sale securities. Realized gains and losses recorded on the sale of investment securities available for sale are based on the specific identification method and included in realized gain (loss) on sale of securities and related hedges in the condensed consolidated statements of operations. Purchase premiums or discounts on investment securities are amortized or accreted to interest income over the estimated life of the investment securities using the effective yield method. Adjustments to amortization are made for actual prepayment activity.

When the fair value of an investment security is less than its amortized cost at the balance sheet date, the security is considered impaired. The Company assesses its impaired securities on at least a quarterly basis, and designates such impairments as either "temporary" or "other-than-temporary." If the Company intends to sell an impaired security, or it is more likely than not that it will be required to sell the impaired security before its anticipated recovery, then it must recognize an other-than-temporary impairment through earnings equal to the entire difference between the investment's amortized cost and its fair value at the balance sheet date. If the Company does not expect to sell an other-than-temporarily impaired security, only the portion of the other-than-temporary impairment related to credit losses is recognized through earnings with the remainder recognized as a component of other comprehensive income (loss) on the condensed consolidated balance sheet. Impairments recognized through other comprehensive income (loss) do not impact earnings. Following the recognition of an other-than-temporary impairment through earnings, a new cost basis is established for the security, which may not be adjusted for subsequent recoveries in fair value through earnings. However, other-than-temporary impairments recognized through earnings may be accreted back to the amortized cost basis of the security on a prospective basis through interest income. The determination as to whether an other-than-temporary impairment exists and, if so, the amount considered other-than-temporarily impaired is subjective, as such determinations are based on both factual and subjective information available at the time of assessment. As a result, the timing and amount of other-than-temporary impairments constitute material estimates that are susceptible to significant change.

The Company's investment securities available for sale also includes its investment in a wholly owned account referred to as the Midway Residential Mortgage Portfolio. The Midway Residential Mortgage Portfolio investments include interest only and inverse interest only securities issued or guaranteed by a GSE (collectively referred to as "IOs") and U.S. Treasury securities. Since the Midway Residential Mortgage Portfolio investments include derivative investments not designated as hedging instruments, unrealized gains and losses are recognized through earnings in the condensed consolidated statements of operations. Therefore, the Company has elected the fair value option for these investment securities which also measures unrealized gains and losses through earnings in the condensed consolidated statements of operations. The Company believes this accounting treatment more accurately and consistently reflects their results of operations.

Cash and Cash Equivalents - Cash and cash equivalents include cash on hand, amounts due from banks and overnight deposits. The Company maintains its cash and cash equivalents in highly rated financial institutions, and at times these balances exceed insurable amounts.

Restricted Cash - Restricted cash consists of amounts designated for investments in our Midway Residential Mortgage Portfolio.

Receivables and Other Assets - Receivables and other assets totaled $9.8 million as of March 31, 2011, and consist primarily of $4.0 million of assets related to discontinued operations, $1.9 million of restricted cash held by third parties, $1.5 million related to escrow advances, $0.8 million of accrued interest receivable, $0.6 million of real estate owned (“REO”) in securitization trusts, $0.6 million of capitalization expenses related to equity and bond issuance cost, $0.2 million of prepaid expenses and $0.1 million of deferred tax asset. The restricted cash held by third parties of $1.9 million includes $1.7 million held by counterparties as collateral for hedging instruments and $0.2 million as collateral for a letter of credit related to the lease of the Company’s corporate headquarters. Receivables and other assets totaled $8.9 million as of December 31, 2010, and consist of $4.0 million of assets related to discontinued operations, $1.4 million of restricted cash held by third parties, $1.1 million related to escrow advances, $0.7 million of real estate owned (“REO”) in securitization trusts, $0.6 million of capitalization expenses related to equity and bond issuance cost, $0.6 million of accrued interest receivable, $0.4 million of prepaid expenses and $0.1 million of deferred tax asset. The restricted cash held by third parties of $1.4 million includes $1.2 million held by counterparties as collateral for hedging instruments and $0.2 million as collateral for a letter of credit related to the lease of the Company’s corporate headquarters.

Mortgage Loans Held in Securitization Trusts - Mortgage loans held in securitization trusts are certain adjustable rate mortgage ("ARM") loans transferred to New York Mortgage Trust 2005-1, New York Mortgage Trust 2005-2 and New York Mortgage Trust 2005-3 that have been securitized into sequentially rated classes of beneficial interests. Mortgage loans held in securitization trusts are carried at their unpaid principal balances, net of unamortized premium or discount, unamortized loan origination costs and allowance for loan losses.

Interest income is accrued and recognized as revenue when earned according to the terms of the mortgage loans and when, in the opinion of management, it is collectible. The accrual of interest on loans is discontinued when, in management’s opinion, the interest is not collectible in the normal course of business, but in no case when payment becomes greater than 90 days delinquent. Loans return to accrual status when principal and interest become current and are anticipated to be fully collectible.

Mortgage Loans Held for Investment - Mortgage loans held for investment are stated at unpaid principal balance, adjusted for any unamortized premium or discount, deferred fees or expenses, net of valuation allowances. Interest income is accrued on the principal amount of the loan based on the loan’s contractual interest rate. Amortization of premiums and discounts is recorded using the effective yield method. Interest income, amortization of premiums and discounts and prepayment fees are reported in interest income. Loans are considered to be impaired when it is probable that, based upon current information and events, the Company will be unable to collect all amounts due under the contractual terms of the loan agreement. Based on the facts and circumstances of the individual loans being impaired, loan specific valuation allowances are established for the excess carrying value of the loan over either: (i) the present value of expected future cash flows discounted at the loan’s original effective interest rate, (ii) the estimated fair value of the loan’s underlying collateral if the loan is in the process of foreclosure or otherwise collateral dependent, or (iii) the loan’s observable market price.

Investment in Limited Partnership Interest – The Company has an equity investment in a limited partnership. In circumstances where the Company has a non-controlling interest but either owns a significant interest or is able to exert influence over the affairs of the enterprise, the Company utilizes the equity method of accounting. Under the equity method of accounting, the initial investment is increased each period for additional capital contributions and a proportionate share of the entity’s earnings and decreased for cash distributions and a proportionate share of the entity’s losses.

Management periodically reviews its investments for impairment based on projected cash flows from the entity over the holding period. When any impairment is identified, the investments are written down to recoverable amounts.

Allowance for Loan Losses on Mortgage Loans Held in Securitization Trusts - We establish an allowance for loan losses based on management's judgment and estimate of credit losses inherent in our portfolio of mortgage loans held in securitization trusts.

Estimation involves the consideration of various credit-related factors including but not limited to, macro-economic conditions, the current housing market conditions, loan-to-value ratios, delinquency status, historical credit loss severity rates, purchased mortgage insurance, the borrower's current economic condition and other factors deemed to warrant consideration. Additionally, we look at the balance of any delinquent loan and compare that to the current value of the collateralizing property. We utilize various home valuation methodologies including appraisals, broker pricing opinions (“BPOs”), internet-based property data services to review comparable properties in the same area or consult with a realtor in the property's area.

Comparing the current loan balance to the property value determines the current loan-to-value (“LTV”) ratio of the loan. Generally, we estimate that a first lien loan on a property that goes into a foreclosure process and becomes real estate owned (“REO”), results in the property being disposed of at approximately 84% of the current appraised value. This estimate is based on management's experience as well as realized severity rates since issuance of our securitizations. During 2008, as a result of the significant deterioration in the housing market, we revised our policy to estimate recovery values based on current home valuations less expected costs to dispose. These costs typically approximate 16% of the current home value. It is possible given continued difficult real estate market conditions in many geographic regions that we may realize less than that return in certain cases. Thus, for a first lien loan that is delinquent, we will adjust the property value down to approximately 84% of the current property value and compare that to the current balance of the loan. The difference determines the base provision for the loan loss taken for that loan. This base provision for a particular loan may be adjusted if we are aware of specific circumstances that may affect the outcome of the loss mitigation process for that loan. Predominately, however, we use the base reserve number for our reserve.

The allowance for loan losses will be maintained through ongoing provisions charged to operating income and will be reduced by loans that are charged off. As of March 31, 2011 and December 31, 2010, the allowance for loan losses held in securitization trusts totaled $2.6 million.

Financing Arrangements, Portfolio Investments - Investment securities available for sale are typically financed with repurchase agreements, a form of collateralized borrowing which is secured by the securities on the balance sheet. Such financings are recorded at their outstanding principal balance with any accrued interest due recorded as an accrued expense.

With respect to interest rate swaps and caps that have not been designated as hedges, any net payments under, or fluctuations in the fair value of, such swaps and caps, will be recognized in current earnings.

Termination of Hedging Relationships - The Company employs a number of risk management monitoring procedures to ensure that the designated hedging relationships are demonstrating, and are expected to continue to demonstrate, a high level of effectiveness. Hedge accounting is discontinued on a prospective basis if it is determined that the hedging relationship is no longer highly effective or expected to be highly effective in offsetting changes in fair value of the hedged item.

Additionally, the Company may elect to un-designate a hedge relationship during an interim period and re-designate upon the rebalancing of a hedge profile and the corresponding hedge relationship. When hedge accounting is discontinued, the Company continues to carry the derivative instruments at fair value with changes recorded in current earnings.

Revenue Recognition - Interest income on our residential mortgage loans and mortgage-backed securities is a combination of the interest earned based on the outstanding principal balance of the underlying loan/security, the contractual terms of the assets and the amortization of yield adjustments, principally premiums and discounts, using generally accepted interest methods. The net GAAP cost over the par balance of self-originated loans held for investment and premium and discount associated with the purchase of mortgage-backed securities and loans are amortized into interest income over the lives of the underlying assets using the effective yield method as adjusted for the effects of estimated prepayments. Estimating prepayments and the remaining term of our interest yield investments require management judgment, which involves, among other things, consideration of possible future interest rate environments and an estimate of how borrowers will react to those environments, historical trends and performance. The actual prepayment speed and actual lives could be more or less than the amount estimated by management at the time of origination or purchase of the assets or at each financial reporting period.

With respect to interest rate swaps and caps that have not been designated as hedges, any net payments under, or fluctuations in the fair value of, such swaps and caps will be recognized in current earnings.

Collateralized Debt Obligations (“CDO”) - We use CDOs to permanently finance our loans held in securitization trusts. For financial reporting purposes, the ARM loans held as collateral are recorded as assets of the Company and the CDO is recorded as the Company’s debt. The transaction includes interest rate caps which are held by the securitization trust and recorded as an asset or liability of the Company. The Company has completed four securitizations since inception, the first three were accounted for as a permanent financing and the fourth was accounted for as a sale and accordingly, not included in the Company’s financial statements.

Subordinated Debentures (Net) - Subordinated debentures are trust preferred securities that are fully guaranteed by the Company with respect to distributions and amounts payable upon liquidation, redemption or repayment. These securities are classified as subordinated debentures in the liability section of the Company’s condensed consolidated balance sheet.

Convertible Preferred Debentures (Net) - The Company issued $20.0 million in Series A Convertible Preferred Stock that matured on December 31, 2010. The outstanding shares were redeemed by the Company at the $20.00 per share liquidation preference plus accrued dividends on December 31, 2010.

Derivative Financial Instruments - The Company has developed risk management programs and processes, which include investments in derivative financial instruments designed to manage interest rate and prepayment risk associated with its securities investment activities.

Derivative instruments contain an element of risk in the event that the counterparties may be unable to meet the terms of such agreements. The Company minimizes its risk exposure by limiting the counterparties with which it enters into contracts to banks and investment banks who meet established credit and capital guidelines. Management does not expect any counterparty to default on its obligations and, therefore, does not expect to incur any loss due to counterparty default. In addition, all outstanding interest rate swap agreements have bi-lateral margin call capabilities, meaning the Company will require margin for interest rate swaps that are in the Company’s favor, minimizing any amounts at risk.

The Company invests in To Be Announced securities (“TBAs”) through its Midway Residential Mortgage Portfolio. TBAs are forward-settling purchases and sales of Agency RMBS where the underlying pools of mortgage loans are “To-Be-Announced.” Pursuant to these TBA transactions, we agree to purchase or sell, for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered is not identified until shortly before the TBA settlement date. For TBA contracts that we have entered into, we have not asserted that physical settlement is probable, therefore we have not designated these forward commitments as hedging instruments. Realized and unrealized gains and losses associated with these TBAs are recognized through earnings in the condensed consolidated statements of operations.

Interest Rate and Prepayment Risk - The Company hedges the aggregate risk of interest rate fluctuations with respect to its borrowings, regardless of the form of such borrowings, which require payments based on a variable interest rate index, as well as prepayment risk associated with its Midway Residential Mortgage Portfolio. With respect to interest rate risk, the Company generally intends to hedge the risk related to changes in the benchmark interest rate (London Interbank Offered Rate (“LIBOR”). The Company applies hedge accounting for certain interest rate hedges utilizing the cash flow hedge criteria.

In order to reduce such interest rate risk, the Company enters into swap agreements whereby the Company receives floating rate payments in exchange for fixed rate payments, effectively converting the borrowing to a fixed rate. The Company also enters into cap agreements whereby, in exchange for a premium, the Company is reimbursed for interest paid in excess of a certain capped rate.

To qualify for cash flow hedge accounting, interest rate swaps and caps must meet certain criteria, including:

- the items to be hedged expose the Company to interest rate risk; and

- the interest rate swaps or caps are expected to be highly effective in reducing the Company's exposure to interest rate risk.

The fair values of the Company's interest rate swap agreements and interest rate cap agreements are based on values provided by dealers who are familiar with the terms of these instruments. Correlation and effectiveness are periodically assessed at least quarterly based upon a comparison of the relative changes in the fair values or cash flows of the interest rate swaps and caps and the items being hedged.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e. hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instruments are reported as a component of OCI and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instruments in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in current earnings during the period of change.

In addition to utilizing interest rate swaps and caps, we may purchase or sell short U.S. Treasury securities or enter into Eurodollar futures contracts to help mitigate the potential impact of changes in interest rates on the performance of the Midway Residential Mortgage Portfolio. We may borrow U.S. Treasury securities to cover short sales of U.S. Treasury securities under reverse repurchase agreements. We account for the securities borrowing transactions as a receivable under reverse repurchase agreements on our condensed consolidated balance sheet. The short sales of U.S. Treasury securities are accounted for as securities sold short, at fair value on our condensed consolidated balance sheet. For instruments that are not designated or qualify as a cash flow hedge, such as our use of U.S. Treasury securities or Eurodollar futures contracts, any realized and unrealized gains and losses associated with these instruments are recognized through earnings in the condensed consolidated statement of operations.

With respect to a Eurodollar futures contract, initial margin deposits are made upon entering into futures contracts and can be either cash or securities. During the period the futures contract is open, changes in the value of the contract are recognized as unrealized gains or losses by marking to market on a daily basis to reflect the market value of the contract at the end of each day’s trading. Variation margin payments are made or received periodically, depending upon whether unrealized gains or losses are incurred. When the contract is closed, the Company records a realized gain or loss equal to the difference between the proceeds of the closing transaction and the Company’s basis in the contract.

The Company uses TBAs to hedge interest rate risk and the aggregate risk of prepayments associated with its Midway Residential Mortgage Portfolio. For example, we may utilize TBAs to hedge the interest rate or yield spread risk inherent in our long Agency RMBS by taking short positions in TBAs that are similar in character. In a TBA transaction, we would agree to purchase or sell for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered is not identified until shortly before the TBA settlement date. The Company typically does not take delivery of TBAs, but rather settles with its trading counterparties on a net basis. TBAs are liquid and have quoted market prices and represent the most actively traded class of RMBS.

Other Comprehensive Income (Loss) - Other comprehensive income (loss) is comprised primarily of income (loss) from changes in value of certain of the Company's available for sale securities and the impact of deferred gains or losses on changes in the fair value of certain derivative contracts that hedges future cash flows.

Employee Benefits Plans - The Company sponsors a defined contribution plan (the "Plan") for all eligible domestic employees. The Plan qualifies as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the Plan, participating employees may defer up to 15% of their pre-tax earnings, subject to the annual Internal Revenue Code contribution limit. The Company may match contributions up to a maximum of 25% of the first 5% of salary. Employees vest immediately in their contribution and vest in the Company's contribution, if any, at a rate of 25% after two full years and then an incremental 25% per full year of service until fully vested at 100% after five full years of service. The Company made no contributions to the Plan for the three months ended March 31, 2011 and 2010.

Stock Based Compensation - Compensation expense for equity based awards is recognized over the vesting period of such awards, based upon the fair value of the stock at the grant date.

Income Taxes - The Company operates so as to qualify as a REIT under the requirements of the Internal Revenue Code. Requirements for qualification as a REIT include various restrictions on ownership of the Company's stock, requirements concerning distribution of taxable income and certain restrictions on the nature of assets and sources of income. A REIT must distribute at least 90% of its taxable income to its stockholders of which 85% plus any undistributed amounts from the prior year must be distributed within the taxable year in order to avoid the imposition of an excise tax. The remaining distribution balance may extend until the timely filing of the Company's tax return in the subsequent taxable year. Qualifying distributions of taxable income are deductible by a REIT in computing taxable income.

HC is a taxable REIT subsidiary and therefore subject to corporate federal income taxes. Accordingly, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax base upon the change in tax status. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Accounting Standards Codification Topic 740 Accounting for Income Taxes ("ASC 740") provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Company's tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained by the applicable tax authority. In situations involving uncertain tax positions related to income tax matters, we do not recognize benefits unless it is more likely than not that they will be sustained. ASC 740 was applied to all open taxable years as of the effective date. Management's determinations regarding ASC 740 may be subject to review and adjustment at a later date based on factors including, but not limited to, an ongoing analysis of tax laws, regulations and interpretations thereof. The Company will recognize interest and penalties, if any, related to uncertain tax positions as income tax expense.

Earnings Per Share - Basic earnings per share excludes dilution and is computed by dividing net income available to common stockholders by the weighted-average number of shares of common stock outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company.

Loans Sold to Third Parties – The Company sold its discontinued mortgage lending business in March 2007. In the normal course of business, the Company is obligated to repurchase loans based on violations of representations and warranties in the loan sale agreements. The Company did not repurchase any loans during the three months ended March 31, 2011 and 2010.

The Company periodically receives repurchase requests based on alleged violations of representations and warranties, each of which management reviews to determine, based on management's experience, whether such requests may reasonably be deemed to have merit. As of March 31, 2011, we had a total of $2.0 million of unresolved repurchase requests that management concluded may reasonably be deemed to have merit, against which the Company has a reserve of approximately $0.3 million. The reserve is based on one or more of the following factors; historical settlement rates, property value securing the loan in question and specific settlement discussions with third parties.

A Summary of Recent Accounting Pronouncements Follows:

Receivables (ASC 310)

In April 2011, the FASB issued ASU No. 2011-02, Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring. ASU 2011-02 clarifies whether loan modifications constitute troubled debt restructuring. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. ASU 2011-02 is effective for the first interim and annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. We are assessing the impact of ASU 2011-02 on our financial condition, results of operations and disclosures.

Transfers and Servicing (ASC 860)

In April 2011, the FASB issued ASU No. 2011-03, Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements. ASU 2011-03 is intended to improve financial reporting of repurchase agreements ("repos") and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. In a typical repo transaction, an entity transfers financial assets to a counterparty in exchange for cash with an agreement for the counterparty to return the same or equivalent financial assets for a fixed price in the future. FASB Accounting Standards Codification ("Codification") Topic 860, Transfers and Servicing, prescribes when an entity may or may not recognize a sale upon the transfer of financial assets subject to repo agreements. That determination is based, in part, on whether the entity has maintained effective control over the transferred financial assets. The amendments to the Codification in this ASU are intended to improve the accounting for these transactions by removing from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets. The guidance in the ASU is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. We are assessing the impact of ASU 2011-03 on our financial condition, results of operations and disclosures.

2. Investment Securities Available for Sale

Investment securities available for sale consist of the following as of March 31, 2011 (dollar amounts in thousands):

Amortized Cost