

Western Asset Mortgage Capital Corp
Form 10-Q
November 14, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2013

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to

Commission File Number: 001-35543

Western Asset Mortgage Capital Corporation

(Exact name of Registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

27-0298092
(IRS Employer
Identification Number)

Western Asset Mortgage Capital Corporation

385 East Colorado Boulevard

Pasadena, California 91101

(Address of Registrant's principal executive offices)

(626) 844-9400

(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 No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 under the Securities Exchange Act of 1934). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

As of November 14, 2013, there were 24,304,503 shares, par value \$0.01, of the registrant's common stock issued and outstanding.

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Table of Contents**Western Asset Mortgage Capital Corporation****Balance Sheets (Unaudited)****(in thousands except share and per share data)**

	September 30, 2013	December 31, 2012
Assets:		
Cash and cash equivalents	\$ 39,369	\$ 56,292
Mortgage-backed securities, at fair value (\$3,495,183 and \$5,043,824 pledged as collateral, at fair value, respectively)	3,562,352	5,212,581
Investment related receivables (\$139,126 and \$0 pledged as collateral, at fair value, respectively)	147,540	
Accrued interest receivable	13,389	17,361
Due from counterparties	44,116	54,142
Derivative assets, at fair value	61,831	24,344
Other assets	534	244
Total Assets	\$ 3,869,131	\$ 5,364,964
Liabilities and Stockholders' Equity:		
Liabilities:		
Borrowings under repurchase agreements	\$ 3,308,870	\$ 4,794,730
Accrued interest payable	7,121	6,561
Investment related payables	48,512	
Due to counterparties	61,598	
Derivative liabilities, at fair value	9,102	4,771
Cash overdraft payable		5,666
Accounts payable and accrued expenses	1,476	988
Underwriting and offering costs payable	8	75
Payable to related party	2,032	1,924
Dividends payable	21,883	27,041
Total Liabilities	3,460,602	4,841,756
Commitments and contingencies		
Stockholders' Equity:		
Common stock, \$0.01 par value, 500,000,000 shares authorized, 24,304,503 and 24,143,944 shares issued and outstanding, respectively	243	241
Preferred stock, \$0.01 par value, 100,000,000 shares authorized and no shares outstanding		
Additional paid-in capital	506,229	505,454
Retained earnings (accumulated deficit)	(97,943)	17,513
Total Stockholders' Equity	408,529	523,208
Total Liabilities and Stockholders' Equity	\$ 3,869,131	\$ 5,364,964

See notes to unaudited financial statements.

Table of Contents**Western Asset Mortgage Capital Corporation****Statement of Operations (Unaudited)**

(in thousands except share and per share data)

	For the three months ended September 30, 2013	For the three months ended September 30, 2012 as Revised (See Note 2)	For the nine months ended September 30, 2013	For the period from May 15, 2012 (commencement of operations) through September 30, 2012, as Revised (See Note 2)
Net Interest Income:				
Interest income	\$ 30,654	\$ 12,987	\$ 97,146	\$ 20,070
Interest expense	4,273	1,935	13,976	2,660
Net Interest Income	26,381	11,052	83,170	17,410
Other Income (Loss):				
Interest income on cash balances and other income	11	2	56	2
Realized gain (loss) on sale of Mortgage-backed securities and other securities, net	(46,142)	6,635	(63,885)	7,792
Other loss on Mortgage-backed securities	(2,363)	(1,352)	(8,164)	(1,439)
Unrealized gain (loss) on Mortgage-backed securities and other securities, net	37,528	26,225	(173,517)	29,208
Gain (loss) on linked transactions, net	(547)		3,958	
Gain (loss) on derivative instruments, net	(3,809)	(12,245)	120,505	(17,404)
Other Income (Loss), net	(15,322)	19,265	(121,047)	18,159
Operating Expenses:				
General and administrative (includes \$287, \$157, \$824 and \$211 non-cash stock based compensation, respectively)	1,484	1,321	4,762	1,905
Management fee related party	2,032	802	5,971	1,209
Total Operating Expenses	3,516	2,123	10,733	3,114
Net income (loss) to Common Stock and participating securities	\$ 7,543	\$ 28,194	\$ (48,610)	\$ 32,455
Net income (loss) per Common Share Basic	\$ 0.31	\$ 2.73	\$ (2.04)	\$ 3.14
Net income (loss) per Common Share Diluted	\$ 0.31	\$ 2.72	\$ (2.04)	\$ 3.14
Dividends Declared per Share of Common Stock	\$ 0.90	\$ 0.85	\$ 2.75	\$ 1.23

See notes to unaudited financial statements.

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Western Asset Mortgage Capital Corporation

Statement of Changes in Stockholders' Equity (Unaudited)

(in thousands except shares and share data)

	Common Stock Shares	Par	Additional Paid- In Capital	Retained Earnings (Accumulated Deficit)	Total
Balance at December 31, 2012	24,143,944	\$ 241	\$ 505,454	\$ 17,513	\$ 523,208
Grants of restricted stock	160,559	2	(2)		
Vesting of restricted stock			777		777
Net income (loss)				(48,610)	(48,610)
Dividends on common stock				(66,846)	(66,846)
Balance at September 30, 2013	24,304,503	\$ 243	\$ 506,229	\$ (97,943)	\$ 408,529

See notes to unaudited financial statements.

Table of Contents**Western Asset Mortgage Capital Corporation****Statement of Cash Flows (Unaudited)**

(in thousands)

	For the nine months ended September 30, 2013	For the period from May 15, 2012 (commencement of operations) through September 30, 2012, as Revised (See Note 2)
Cash flows from operating activities:		
Net income (loss)	\$ (48,610)	\$ 32,455
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Premium amortization and (discount accretion), net	19,061	6,230
Restricted stock amortization expense	824	211
Unrealized loss (gain) on Mortgage-backed securities and other securities, net	173,517	(29,208)
Mark-to-market adjustments on linked transactions	(846)	
Mark-to-market adjustments on derivative instruments	(42,884)	16,616
Other loss on Mortgage-backed securities	8,164	1,439
Realized loss (gain) on sale of Mortgage-backed securities and other securities, net	63,885	(7,792)
Realized loss on sale of Interest-Only Strips accounted for as derivatives, net	99	
Realized loss on TBAs, net	1,547	
Realized gain on sale of swaptions, net	(23,671)	
Realized loss on expiration of option derivatives, net	925	
Realized gain on linked transaction, net	(3,049)	
Changes in operating assets and liabilities:		
Decrease (increase) in accrued interest receivable	3,972	(9,330)
Increase in other assets	(290)	(405)
Increase in accrued interest payable	560	4,033
Increase in accounts payable and accrued expenses	441	845
Increase in payable to related party	108	810
Net cash provided by operating activities	153,753	15,904
Cash flows from investing activities:		
Purchase of Mortgage-backed securities and other securities	(1,833,371)	(2,956,569)
Purchase of securities underlying linked transactions	(96,023)	
Proceeds from sale of Mortgage-backed securities and other securities	2,748,309	814,448
Proceeds from sale of securities underlying linked transactions	21,735	
Principal payments and basis recovered on Mortgage-backed securities	236,226	40,786
Principal payments on securities underlying linked transactions	1,138	
Payment of premium for option derivatives	(4,675)	
Premium received from option derivatives	3,750	
Proceeds from gross settlement of TBAs	208,313	
Net settlements of TBAs	(1,043)	
Proceeds from sale of interest rate swaptions	60,482	
Payment of premium for interest rate swaptions	(23,544)	(1,230)
Net cash provided by (used in) investing activities	1,321,297	(2,102,565)
Cash flows from financing activities:		

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Proceeds from issuance of common stock		160,000
Proceeds from private placements of units and common stock (concurrent with initial public offering)		45,557
Redemption of common stock		(1)
Payment of offering costs	(67)	(1,278)
Proceeds from repurchase agreement borrowings	25,528,226	7,393,018
Proceeds from repurchase agreements underlying linked transactions	103,902	
Repayments of repurchase agreement borrowings	(27,014,086)	(5,469,501)
Repayments of repurchase agreements underlying linked transactions	(103,902)	
Repayment of cash overdraft	(5,666)	
Due from counterparties	10,026	(24,780)
Due to counterparties	61,598	7,035
Dividends on common stock	(72,004)	(3,931)
Net cash provided by (used in) financing activities	(1,491,973)	2,106,119
Net increase (decrease) in cash and cash equivalents	(16,923)	19,458
Cash and cash equivalents beginning of period	56,292	1
Cash and cash equivalents end of period	\$ 39,369	\$ 19,459
Supplemental disclosure of operating cash flow information:		
Interest paid	\$ 15,607	\$ 1,923
Supplemental disclosure of non-cash financing/investing activities:		
Underwriting and offering costs payable	\$	\$ 5,323
Mortgage-backed securities sold, not settled	\$ 147,540	\$ 182,741
Mortgage-backed securities purchased, not settled	\$ (48,512)	\$ (2,669,070)
Mortgage-backed securities used to settle TBAs	\$ 208,817	\$
Mortgage-backed securities recorded upon unlinking of linked transactions	\$ (77,046)	\$
Stock subscription receivable	\$	\$ 306,360
Dividends and distributions declared, not paid	\$ 21,883	\$ 8,792

See notes to unaudited financial statements.

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Western Asset Mortgage Capital Corporation

Notes to Financial Statements (Unaudited)

(in thousands - except share and per share data)

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

Note 1 Organization

Western Asset Mortgage Capital Corporation (is referred to throughout this report as the Company) is a real estate finance company that primarily invests in residential mortgage assets in the United States. Although the Company's core investment strategy is primarily focused on Agency RMBS, the Company has supplemented its portfolio with Non-Agency RMBS, Agency and Non-Agency CMBS and, under current market conditions, expects to increase its investment in Non-Agency RMBS and Agency and Non-Agency CMBS in the future. In addition, the Company may opportunistically invest in asset-backed securities (ABS) as well.

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

At December 31, 2011 and through May 14, 2012, the Company complied with the reporting requirements for development stage enterprises and was subject to the risks associated with development stage enterprises. The Company completed its initial public offering and began its core operation on May 15, 2012. The Company incurred organizational, accounting and offering costs in connection with the Company's initial public offering (the IPO) of its common stock and concurrent private placements. In accordance with the Management Agreement (as defined herein in Note 10) between the Company and the Manager, the Company reimbursed the Manager for \$1.2 million of offering and other related organization costs, which were paid by the Manager, from the proceeds of the IPO and concurrent private placements. The Manager paid all costs in excess of \$1.2 million. The Company ceased reporting as a development stage company on May 15, 2012.

Note 2 Revision of Previously Issued Financial Statements for Errors Affecting Certain Items Presented in the Statements of Operations and Statements of Cash Flows

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As previously reported in the Company's annual report on Form 10-K for 2012, during the process of preparing the Company's 2012 financial statements, the Company discovered that the methodology that was used to accrete interest income and to amortize the cost basis of certain of the Company's residential mortgage backed securities, which was based on a third party vendor's system, as well as the presentation with regard to certain items in its Statement of Cash Flows were not in accordance with GAAP. The Company has evaluated the impact of these errors and has concluded that individually and in the aggregate, these errors were not material to any previously issued financial statements. However, the Company elected to revise the Statements of Operations for the three months ended September 30, 2012 and for the period from May 15, 2012 (commencement of operations) through September 30, 2012, and the Statements of Cash Flows for the period from May 15, 2012 (commencement of operations) through September 30, 2012 in this quarterly financial statements on Form 10-Q to correct these errors. The corrections resulted in a reclassification of a portion of the Company's previously reported net interest income to realized and unrealized gains, and certain amounts previously reflected in operating cash flows to investing cash flows (as indicated in the tables below). These revisions had no effect on net income, shareholders' equity, net change in cash, or total assets, of the Company reported for this period.

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Statements of Operations for the three months ended September 30, 2012 and for the period from May 15, 2012 (commencement of operations) through September 30, 2012:

Amounts in thousands, except share and per share amounts	Three months ended September 30, 2012			Period from May 15, 2012 (commencement of operations) through September 30, 2012		
	As Originally Reported	Adjustments	Revised	As Originally Reported	Adjustments	Revised
Net interest income:						
Interest income	\$ 14,688	\$ (1,701)	\$ 12,987	\$ 21,538	\$ (1,468)	\$ 20,070
Interest expense	1,935		1,935	2,660		2,660
Net interest income	12,753	(1,701)	11,052	18,878	(1,468)	17,410
Other Income (loss):						
Interest income on cash balances	2		2	2		2
Realized gain on sale of Mortgage-backed securities, net	6,454	181	6,635	7,574	218	7,792
Other loss on Mortgage-backed securities	(5,545)	4,193	(1,352)	(6,150)	4,711	(1,439)
Unrealized gain on Mortgage-backed securities, net	28,329	(2,104)	26,225	32,254	(3,046)	29,208
Loss on derivative instruments, net	(11,676)	(569)	(12,245)	(16,989)	(415)	(17,404)
Other Income, net	17,564	1,701	19,265	16,691	1,468	18,159
Operating Expenses:						
General and administrative	1,321		1,321	1,905		1,905
Management fee - related party	802		802	1,209		1,209
Total Operating Expenses	2,123		2,123	3,114		3,114
Net income available to Common Stock and Participating Securities	\$ 28,194	\$	\$ 28,194	\$ 32,455	\$	\$ 32,455
Earnings per share						
Net income attributable to common and participating shareholders (basic)	\$ 2.73	\$	\$ 2.73	\$ 3.14	\$	\$ 3.14
Net income attributable to shareholders (diluted)	\$ 2.72	\$	\$ 2.72	\$ 3.14	\$	\$ 3.14

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Statement of Cash Flows (summarized) for the periods from May 15, 2012 (commencement of operations) through September 30, 2012:

Amounts in thousands	Period from May 15, 2012 (commencement of operations) through September 30, 2012		
	As Originally Reported	Adjustments	Revised
Statement of Cash Flows (effect on individual line items)			
Net income	\$ 32,455	\$	\$ 32,455
Adjustments to reconcile net income to net cash provided by operating activities:			
Premium amortization and (discount accretion), net	9,054	(2,824)	6,230
Unrealized (gain) loss on Mortgage-backed securities and other securities, net	(32,254)	3,046	(29,208)
Mark-to-market adjustments on derivative instruments	17,076	(460)	16,616
Other loss on Mortgage-backed securities	6,150	(4,711)	1,439
Realized (gain) loss on sale of Mortgage-backed securities and other securities, net	(7,574)	(218)	(7,792)
All other items	(3,836)		(3,836)
Net cash provided by operating activities	21,071	(5,167)	15,904
Cash flows from investing activities:			
Principal payments and basis recovered on Mortgage-backed securities and other securities	35,619	5,167	40,786
All other items	(2,143,351)		(2,143,351)
Net cash used in investing activities	(2,107,732)	5,167	(2,102,565)
Cash flows from financing activities:			
All items	2,106,119		2,106,119
Net cash provided by financing activities	2,106,119		2,106,119
Net increase in cash and cash equivalents			
Cash and cash equivalents beginning of period	1		1
Cash and cash equivalents end of period	\$ 19,459	\$	\$ 19,459

Note 3 Summary of Significant Accounting Policies

Basis of Presentation

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The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (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 periods. Actual results could differ from those estimates.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary have been made to present fairly the Company's financial position, results of operations and cash flows. 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 financial statements should be read in conjunction with the Company's annual report on Form 10-K for the year ended December 31, 2012, filed with the Securities and Exchange Commission (SEC) on April 9, 2013. The results of operations for the period ended September 30, 2013 are not necessarily indicative of the results to be expected for the full year or any future period.

The Company currently operates as one business segment.

Cash and Cash Equivalents

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

Classification of mortgage-backed securities and valuations of financial instruments

Mortgage-backed and US Treasury securities - Fair value election

The Company has elected the fair value option for all of its MBS and US Treasury securities at the date of purchase, which permits the Company to measure these securities at fair value with the change in fair value included as a component of earnings. In the Manager's view, this election more appropriately reflects the results of the Company's operations for a particular reporting period, as financial asset fair value changes are presented in a manner consistent with the presentation and timing of the fair value changes of economic hedging instruments.

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Balance Sheet Presentation

The Company's mortgage-backed securities purchases and sales are recorded on the trade date, which results in an investment related payable (receivable) for MBS purchased (sold) for which settlement has not taken place as of the balance sheet date. The Company's MBS are pledged as collateral against borrowings under repurchase agreements. Other than MBS which are accounted for as linked transactions, described below, the Company's MBS are included in Mortgage-backed securities at fair value and Investment related receivables on the Balance Sheets, with the fair value of such MBS pledged disclosed parenthetically.

Valuation of financial instruments

The Company discloses the fair value of its financial instruments according to a fair value hierarchy (Levels I, II, and III, as defined below). In accordance with GAAP, the Company is required to provide enhanced disclosures regarding instruments in the Level III category (which require significant management judgment), including a separate reconciliation of the beginning and ending balances for each major category of assets and liabilities. GAAP establishes a framework for measuring fair value and expands financial statement disclosure requirements for fair value measurements. GAAP further specifies a hierarchy of valuation techniques, which is based on whether the inputs into the valuation technique are observable or unobservable. The hierarchy is as follows:

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

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

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

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

When available, the Company uses quoted market prices to determine the fair value of an asset or liability. If quoted market prices are not available, the Company consults with independent pricing services or obtains third party broker quotes. If independent pricing service, or third party broker quotes are not available, the Company determines the fair value of the securities using valuation techniques that use, when possible, current market-based or independently-sourced market parameters, such as interest rates and when applicable, estimates of prepayment and credit losses.

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Valuation techniques for MBS may be based upon models that consider the estimated cash flows of the security. When applicable, the primary inputs to the model include yields for Agency To-Be-Announced securities (also known as TBAs), Agency MBS, the U.S. Treasury market and floating rate indices such as the London interbank offered rate or LIBOR, the Constant Maturity Treasury rate and the prime rate as a benchmark yield. In addition, the model may incorporate the current weighted average maturity and additional pool level information such as prepayment speeds, default frequencies and default severities, if applicable. To the extent, such inputs are observable and timely, the values are categorized in Level II of the fair value hierarchy; otherwise, unless alternative pricing information as described above is available, they would be categorized as Level III.

While linked transactions, described below, are treated as derivatives for GAAP, the securities underlying the Company's linked transactions are valued using similar techniques to those used for the Company's securities portfolio. The value of the underlying security is then netted against the carrying amount (which approximates fair value) of the repurchase agreement at the valuation date. Additionally, TBA instruments are similar in substance to the Company's Agency RMBS portfolio, and the Company therefore estimates fair value based on similar methods.

The Company determines the fair value of derivative financial instruments by obtaining quotes from a third party pricing service, whose pricing is subject to review by the Manager's pricing committee. In valuing its interest rate derivatives, such as swaps and swaptions, the Company considers the creditworthiness of both the Company and its counterparties, along with collateral provisions contained in each derivative agreement, from the perspective of both the Company and its counterparties. All of the Company's interest rate swaps are either cleared through a central clearinghouse and subject to the clearinghouse margin requirements or subject to bilateral collateral arrangements. The Company also has netting arrangements in place with all derivative counterparties. No credit valuation adjustment was made in determining the fair value of interest rate derivatives.

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In May 2011, the Financial Accounting Standards Board or FASB issued amendments, which were adopted by the Company, to achieve common fair value measurement and disclosure requirements in GAAP and International Financial Reporting Standards. New disclosures, with a particular focus on Level III measurement are required. All transfers between Level I and Level II are required to be disclosed. Information about when the current use of a non-financial asset measured at fair value differs from its highest and best use is to be disclosed.

Fair value under GAAP represents an exit price in the normal course of business, not a forced liquidation price. If the Company is forced to sell assets in a short period to meet liquidity needs, the prices it receives can be substantially less than their recorded fair values. Furthermore, the analysis of whether it is more likely than not that the Company will not be required to sell securities in an unrealized loss position before recovery of its amortized cost basis, the amount of such expected required sales, and the projected identification of which securities will be sold is also subject to significant judgment, particularly in times of market illiquidity.

Any changes to the valuation methodology will be reviewed by the Company and its Manager to ensure the changes are appropriate. As markets and products develop and the pricing for certain products becomes more transparent, the Company will continue to refine its valuation methodologies. The Company utilizes and follows the pricing methodology employed by its Manager, including its review and challenge process. The methods used by the Company may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company anticipates that its valuation methods will be appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments can result in a different estimate of fair value at the reporting date. The Company uses inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced.

Interest income recognition and Impairment

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

Interest income on mortgage-backed securities is accrued based on the respective outstanding principal balances and corresponding contractual terms. Premiums and discounts associated with Agency MBS and Non-Agency MBS, excluding Interest-Only Strips, rated AA and higher at the time of purchase, are amortized into interest income over the estimated life of such securities using the effective yield method. Adjustments to premium and discount amortization are made for actual prepayment activity. The Company estimates prepayments at least quarterly for its securities and as a result, if prepayments increase (or are expected to increase), the Company will accelerate the rate of amortization on premiums or discounts and make a retrospective adjustment to historical amortization. Alternatively, if prepayments decrease (or are expected to decrease) the Company will reduce the rate of amortization on the premiums or discounts and make a retrospective adjustment to historical amortization.

The Company assesses its Agency MBS and its Non-Agency MBS, excluding Interest-Only Strips, rated AA and higher at the time of purchase for other-than-temporary impairment on at least a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either temporary or other-than-temporary. In deciding on whether or not a security is other than temporarily impaired, the Company considers several factors, including the nature of the investment, communications (if any) from the trustees of securitizations regarding the credit quality of the security, the severity and duration of the impairment, the cause of the impairment, and the Company's intent not to sell the security and that it is more likely than not that Company will not be required to sell the security until recovery of its amortized cost basis. An other-than-temporary impairment is deemed to have occurred when there is an adverse change in the expected cash flows (principal or interest) to be received and the fair value of the security is less than its carrying amount. In determining whether an adverse change in cash flows occurred, the present value of

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the remaining cash flows, as estimated at the initial transaction date (or the last date previously revised), is compared to the present value of the expected cash flows at the current reporting date. The estimated cash flows reflect those a market participant would use and are discounted at a rate equal to the current yield used to accrete interest income. These adjustments are reflected in the Company's Statement of Operations as Other loss on Mortgage-backed securities.

The determination as to whether an other-than-temporary impairment exists is subject to management estimates based on consideration of both factual information available at the time of assessment as well as the Company's estimates of the future performance and projected amount and timing of cash flows expected to be collected on the security. As a result, the timing and amount of an other-than-temporary impairment constitutes an accounting estimate that may change materially over time.

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

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

Based on the projected cash flow of the Non-Agency MBS purchased at a discount to par value, the Company may designate a portion of such purchase discount as credit protection against future credit losses and, therefore, not accrete such amount into interest income. The amount designated as credit discount may be adjusted over time, based on the actual performance of the security, its underlying collateral, actual and projected cash flow from such collateral, economic conditions and other factors. If the performance of a security with a credit discount is more favorable than forecasted, a portion of the amount designated as credit discount may be accreted into interest income prospectively.

In addition, an other-than-temporary impairment is deemed to have occurred when there is an adverse change in the expected cash flows (principal or interest) to be received and the fair value of the security is less than its carrying amount. In determining whether an adverse change in cash flows occurred, the present value of the remaining cash flows, as estimated at the initial transaction date (or the last date previously revised), is compared to the present value of the expected cash flows at the current reporting date. The estimated cash flows reflect those a market participant would use and are discounted at a rate equal to the current yield used to accrete interest income. These adjustments are reflected in the Company's Statement of Operations as Other loss on Mortgage-backed securities.

The determination as to whether an other-than-temporary impairment exists is subject to management estimates based on consideration of both factual information available at the time of assessment as well as the Company's estimates of the future performance and projected amount and timing of cash flows expected to be collected on the security. As a result, the timing and amount of an other-than-temporary impairment constitutes an accounting estimate that may change materially over time.

Certain of the Company's MBS that are in an unrealized loss position at September 30, 2013 are not considered other than temporarily impaired because the Company has no intent to sell these investments, it is more likely than not that the Company will not be required to sell the investment before recovery of its amortized cost basis and the Company is not required to sell the security for regulatory or other reasons.

Sales of securities

Sales of securities are driven by the Company's portfolio management process. The Company seeks to mitigate risks including those associated with prepayments and will opportunistically rotate the portfolio into securities the Company's Manager believe have more favorable attributes.

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Strategies may also be employed to manage net capital gains, which need to be distributed for tax purposes. Realized gains or losses on sales of securities, including Agency Interest-Only Strips not characterized as derivatives, are included in the net Realized gain (loss) on sale of Mortgage-backed securities and other securities, net line item on the Statement of Operations, and are recorded at the time of disposition. Realized gains or losses on sales of securities which are part of a linked transaction are included in Gain (loss) on linked transactions, net while realized gains losses on Interest-Only Strips which are characterized as derivatives are included in Gain (loss) on derivative instruments, net line item in the Statement of Operations. The cost of positions sold is calculated using the specific identification method.

Securities in an unrealized loss position at the end of each reporting are evaluated by the Company's Manager to determine whether the Company has the intent to sell such securities. To the extent the Company has no intent to sell such investments and it is more likely than not that the Company will not be required to sell the investment before recovery of its amortized cost basis, such unrealized loss is included in Unrealized gain (loss) on Mortgage-backed securities and other securities, net in the Statement of Operations. Otherwise, the Company is deemed to have the intent to sell such securities, the unrealized loss is characterized as a realized loss and included in Other loss on Mortgage-backed securities on the Statement of Operations.

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Due from counterparties/Due to counterparties

Due from counterparties represents cash posted with its counterparties as collateral for the Company's interest rate swaps and repurchase agreements. Due to counterparties represents cash posted with the Company by its counterparties as collateral under the Company's interest rate swaps, interest rate swaptions and repurchase agreements. In addition, as provided below, Due to counterparties may include non-cash collateral in which the Company has the obligation to return the collateral upon the Company either selling or pledging the non-cash collateral. To the extent the Company receives collateral other than cash from its counterparties such assets are not included in the Company's Balance Sheet. Notwithstanding the foregoing, if the Company either rehypothecates such assets or pledges the assets as collateral pursuant to a repurchase agreement, the cash received and the corresponding liability is reflected on the Balance Sheet.

Derivatives and hedging activities

Subject to maintaining its qualification as a REIT for U.S. federal income tax purposes, the Company utilizes derivative financial instruments, including interest rate swaps, swaptions, TBAs and Agency and Non-Agency Interest-Only Strips to hedge the interest rate risk associated with its portfolio and related borrowings. Derivatives are used for hedging purposes rather than speculation. The Company determines the fair value of its derivative positions and obtains quotations from a third party to facilitate the process of determining these fair values. If the Company's hedging activities do not achieve the desired results, reported earnings may be adversely affected.

GAAP requires an entity to recognize all derivatives as either assets or liabilities and to measure those instruments at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives are classified as either hedges of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge) or hedges of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge). Fair value adjustments are recorded in earnings immediately, if the Company does not elect hedge accounting for a derivative instrument.

The Company elected not to apply hedge accounting for its derivative instruments and records the change in fair value and net interest rate swap payments (including accrued amounts) related to interest rate swaps in Gain (loss) on derivative instruments, net in its Statement of Operations.

The Company also invests in Agency and Non-Agency Interest-Only Strips, Agency and Non-Agency Inverse Interest-Only Strips, swaptions and TBAs. The Company evaluates the terms and conditions of its holdings of Agency and Non-Agency Interest-Only Strips, Agency Inverse Interest-Only Strips, swaptions and TBAs to determine if these instruments have the characteristics of an investment or should be considered a derivative under GAAP. Accordingly, Agency and Non-Agency Interest-Only Strips, Agency Inverse Interest-Only Strips, swaptions and TBAs having the characteristics of derivatives are accounted for at fair value with such changes recognized in Gain (loss) on derivative instruments, net in its Statement of Operations, along with any interest earned (including accrued amounts). The carrying value of these Agency and Non-Agency Interest-Only Strips, Agency Inverse Interest-Only Strips, swaptions and TBAs is included in Mortgage-backed securities on the Balance Sheet.

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The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. See Warrants below. Derivative instruments are recorded at fair value and are re-valued at each reporting date, with changes in the fair value together with interest earned (including accrued amounts) reported in the Gain (loss) on derivatives, net in the Statements of Operations.

Repurchase agreements

Mortgage-backed securities sold under repurchase agreements are treated as collateralized financing transactions, unless they meet sales treatment. Securities financed through a repurchase agreement remain on the Company's Balance Sheet as an asset and cash received from the lender is recorded in the Company's Balance Sheet as a liability, unless they are accounted for as linked transactions, described below. Interest paid in accordance with repurchase agreements is recorded as interest expense, unless they are accounted for as linked transactions, described below. The Company reflects all proceeds from repurchase agreement borrowings and repayment of repurchase agreement borrowings which are not linked transactions, including transactions pertaining to collateral received with respect to certain swap transactions, on a gross basis on the Statement of Cash Flows.

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Linked Transactions

In instances where the Company finances securities through repurchase agreements with the same counterparty from which the securities were purchased, the Company accounts for the purchase commitment and repurchase agreement on a net basis and records a forward commitment to purchase securities as a derivative instrument if the transaction does not comply with the criteria for gross presentation. Such forward commitments are recorded at fair value with subsequent changes in fair value recognized in Gain (loss) on linked transactions, net on its Statement of Operations. If the transaction complies with the criteria for gross presentation, the Company records the assets and the related financing on a gross basis in its Balance Sheet and the corresponding interest income and interest expense in its Statement of Operations. The FASB announced that they are in the process of reviewing the current guidance pertaining to linked transactions. For linked transactions, the Company reflects purchases and sales of securities within the investing section of the Statement of Cash Flows. Proceeds from repurchase agreements borrowings and repayments of repurchase agreement borrowings are reflected in the financing section of the Statement of Cash Flows.

Share-based compensation

The Company accounts for share-based compensation to its independent directors, to its employees, to its Manager and to employees of its Manager and its affiliates using the fair value based methodology prescribed by GAAP. Compensation cost related to restricted common stock issued to the Company's independent directors, including any such restricted stock which is subject to a deferred compensation program, and employees of the Company is measured at its fair value at the grant date, and amortized into expense over the service period on a straight-line basis. Compensation cost related to restricted common stock issued to the Manager and to employees of the Manager and its affiliates is initially measured at fair value at the grant date, and amortized into expense over the vesting period on a straight-line basis and re-measured on subsequent dates to the extent the awards are unvested.

Warrants

The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the statements of operations. Financial instruments without the features of liabilities are recorded as a component of equity. For the Company's warrants, the Company uses a variation of the adjusted Black-Scholes option valuation model to record the financial instruments at their relative fair values at issuance. The warrants issued with the Company's common stock in the private placement to certain accredited institutional investors on May 15, 2012, were evaluated by the Company and were recorded at their relative fair value as a component of equity at the date of issuance.

Income taxes

The Company operates and has elected to be taxed as a REIT commencing with its taxable year ended December 31, 2012. Accordingly, the Company will generally not be subject to corporate U.S. federal or state income tax to the extent that the Company makes qualifying distributions to stockholders, and provided that the Company satisfies, on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. If the Company fails to qualify as a REIT, and does

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not qualify for certain statutory relief provisions, the Company will be subject to U.S. federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which the Company lost its REIT qualification. Accordingly, the failure to qualify as a REIT could have a material adverse impact on the Company's results of operations and amounts available for distribution to stockholders.

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

The Company may create and elect to treat certain subsidiaries as Taxable REIT Subsidiaries (TRS). In general, a TRS may hold assets and engage in activities that the Company cannot hold or engage in directly and generally may engage in any real estate or non-real estate-related business. A TRS is subject to U.S. federal, state and local corporate income taxes, and its value may not exceed 25% of the value of the Company. While a TRS will generate net income, a TRS can declare dividends to the Company, which will be included in the Company's taxable income and necessitate a distribution to its stockholders. Conversely, if the Company retains earnings at the TRS level, no distribution is required and it can increase book equity of the consolidated entity. As of September 30, 2013, the Company did not have a TRS, or any other subsidiary.

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The Company evaluates uncertain tax positions, if any, and classifies interest and penalties, if any, related to unrecognized tax benefits as a component of the provision for income taxes.

Offering costs

Offering costs borne by the Company in connection with the IPO and concurrent private placements completed on May 15, 2012 as well as its follow-on public stock offering completed on October 3, 2012 are reflected as a reduction of additional paid-in-capital.

Earnings per share

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

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

Comprehensive Income (Loss)

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

Accounting standards applicable to emerging growth companies

The JOBS Act contains provisions that relax certain requirements for emerging growth companies, which includes the Company. For as long as the Company is an emerging growth company, which may be up to five full fiscal years, unlike other public companies, the Company will not be required to: (i) comply with any new or revised financial accounting standards applicable to public companies until such standards are also applicable to private companies under Section 102(b)(1) of the JOBS Act; (ii) provide an auditor's attestation report on management's assessment of the effectiveness of the Company's system of internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act;

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(iii) comply with any new requirements adopted by the PCAOB requiring mandatory audit firm rotation or a supplement to the auditor's report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer; or (iv) comply with any new audit rules adopted by the PCAOB after April 5, 2012, unless the SEC determines otherwise.

As noted above, under the JOBS Act, emerging growth companies can delay adopting new or revised accounting standards that have different effective dates for public and private companies until such time as those standards apply to private companies. The Company intends to take advantage of such extended transition period. Since the Company will not be required to comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for other public companies, its financial statements may not be comparable to the financial statements of companies that comply with public company effective dates. If the Company were to elect to comply with these public company effective dates, such election would be irrevocable pursuant to Section 107 of the JOBS Act.

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Recent accounting pronouncements

Accounting Standards Adopted in 2013

In December 2011, the FASB issued guidance requiring additional disclosure information about offsetting and related arrangements. Further in December 2012, the FASB proposed an update intended to address implementation of the December 2011 guidance. In January 2013, the FASB issued guidance to limit the scope of the new balance sheet and offsetting disclosure requirements of prior guidance related to certain derivatives (including bifurcated embedded derivatives), repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions. Entities will be required to disclose both gross information and net information about both instruments and transactions eligible for offset in the balance sheet as well as instruments and transactions subject to an agreement similar to a master netting arrangement. This scope would include derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, and securities lending arrangements. The objective of this disclosure is to facilitate comparison between those entities that prepare their financial statements on the basis of GAAP and those entities that prepare their financial statements on the basis of International Financial Reporting Standards. The guidance is effective for periods beginning on or after January 1, 2013 and interim periods within those annual periods. While this guidance did result in certain additional disclosures, it did not have a material impact on the Company's financial statements.

Note 4 Fair Value of Financial Instruments

Fair Value Accounting Elections

The Company's MBS are designated as available-for-sale and has elected the fair value option for all of its MBS, and as a result, all changes in the fair value of such securities are reflected in the results of operations.

Financial Instruments carried at Fair Value

The following tables present the Company's financial instruments, carried at fair value as of September 30, 2013 and December 31, 2012, based upon the valuation hierarchy (dollars in thousands):

	September 30, 2013			Total
	Level I	Level II	Level III	
Assets				
Agency RMBS	\$	\$ 3,181,076	\$	\$ 3,181,076
Agency and Non-Agency Interest-Only Strips accounted for as derivatives, included in MBS		84,861	10,572	95,433

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Non-Agency RMBS		265,644		265,644
Agency and Non-Agency CMBS		20,199		20,199
Subtotal		3,551,780	10,572	3,562,352
Derivative assets		61,831		61,831
Total	\$	\$ 3,613,611	\$ 10,572	\$ 3,624,183
Liabilities				
Derivative liabilities	\$	\$ 9,102	\$	\$ 9,102
Total	\$	\$ 9,102	\$	\$ 9,102

	December 31, 2012			
	Fair value			
	Level I	Level II	Level III	Total
Assets				
Agency RMBS	\$	\$ 5,118,121	\$	\$ 5,118,121
Agency Interest-Only Strips accounted for as derivatives, included in MBS		75,387		75,387
Non-Agency RMBS		19,073		19,073
Subtotal		5,212,581		5,212,581
Derivative assets		24,344		24,344
Total	\$	\$ 5,236,925	\$	\$ 5,236,925
Liabilities				
Derivative liabilities	\$	\$ 4,771	\$	\$ 4,771
Total	\$	\$ 4,771	\$	\$ 4,771

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The following table presents additional information about the Company's MBS which is measured at fair value on a recurring basis for which the Company has utilized Level III inputs to determine fair value:

\$ in thousands	Three months ended September 30, 2013	Three months ended September 30, 2012	Nine months ended September 30, 2013	Period from May 15, 2012 (commencement of operations) through September 30, 2012
Beginning balance				
Transfers into Level III from Level II	7,013		7,013	
Purchases	3,555		3,555	
Sales and settlements				
Principal repayments				
Total net gains / (losses) included in net income				
Realized gains/(losses), net				
Unrealized gains/(losses), net	8		8	
Premium and discount amortization, net	(4)		(4)	
Ending balance	10,572		10,572	

There was one transfer between hierarchy levels during operations for the three and nine months ended September 30, 2013. The assets which were transferred from Level II to Level III as of September 30, 2013, consisted of securities for which the price received from a third party pricing service was challenged and overridden in accordance with the Manager's pricing challenge methodology as explained in more detail below. The valuation for these assets was based on broker price quotations. Accordingly, the Company determined that such assets should be classified as Level III assets.

The Company primarily utilizes an independent third party pricing service as the primary source for valuing the Company's assets. All valuations received from independent pricing services are non-binding. The Company generally receives one independent pricing service price for each investment in its portfolio. The Manager has established a process to review and validate the pricing received from the independent pricing service at the end of the reporting period and has a process for challenging prices received from the independent pricing service when necessary. The Company utilizes its Manager's policies in this regard. The Company's and the Manager's review of the independent third party pricing data may consist of a review of the daily change in the prices provided by the independent pricing vendor which exceed established tolerances or comparisons to executed transaction prices. The Manager's pricing group, which functions independently from its portfolio management personnel, corroborates the price differences or changes in price by comparing the vendor price to alternate sources including other independent pricing services or broker quotations. If the price change or difference cannot be corroborated, the Manager's pricing group consults with the portfolio management team for market color in reviewing such pricing data as warranted. To the extent that the Manager has information, typically in the form of broker quotations that would indicate that a price received from the independent pricing service is outside of a tolerance range, the Manager generally challenges the independent pricing service price. To ensure proper fair value hierarchy, the Company and the Manager review the methodology used by the third party pricing service to understand whether observable market data is being utilized in the vendor's pricing methodology. Generally, this review is conducted annually, however ad-hoc reviews of the pricing methodology and the data does occur. In addition, as part of the Company's regular review of pricing, the Manager's pricing group may have informal discussions with the independent pricing vendor regarding their evaluation methodology or the market data utilized in their determination.

Other Fair Value Disclosures

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Cash and cash equivalents as well as Due from counterparties and Due to counterparties on the Company's Balance Sheets are reflected at cost which approximates fair value.

The fair value of the repurchase agreements is a Level II fair value measurement, based on an expected present value technique. This method discounts future estimated cash flows using rates the Company determined best estimate current market interest rates that would be offered for loans with similar characteristics and credit quality. The use of different market assumptions or estimation methodologies can have a material effect on the fair value amounts. At September 30, 2013, the Company's borrowings under repurchase agreements had a fair value of approximately \$3.3 billion and a carrying value of approximately \$3.3 billion.

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Note 5 Mortgage-Backed Securities

The following table presents certain information about the Company's investment portfolio at September 30, 2013 and December 31, 2012 (dollars in thousands). Real estate securities that are accounted for as a component of linked transactions are not reflected in the tables set forth in this note. See Note 8 for further details.

	September 30, 2013						Net Weighted Average Coupon (1)
	Principal Balance	Unamortized Premium (Discount), net	Discount Designated as Credit Reserve and OTTI	Amortized Cost	Unrealized Gain (Loss), net	Estimated Fair Value	
Agency RMBS:							
20-Year Mortgage	\$ 680,766	\$ 37,333	\$	\$ 718,099	\$ (28,733)	\$ 689,366	3.1%
30-Year Mortgage	2,231,571	191,385		2,422,956	(128,282)	2,294,674	3.7%
Agency RMBS							
Interest-Only Strips	N/A	N/A		198,024	(988)	197,036	4.3%(2)
Agency and Non-Agency Interest-Only Strips, accounted for as derivatives (3)							
	N/A	N/A		N/A	N/A	95,433	4.8%(2)
Non-Agency RMBS	401,748	(59,928)	(74,583)	267,237	(1,593)	265,644	1.1%
Agency and Non-Agency CMBS							
CMBS Interest-Only Strips	11,979	(3,638)		8,341	(16)	8,325	1.6%
	N/A	N/A		11,851	23	11,874	0.7%(2)
Total	\$ 3,326,064	\$ 165,152	\$ (74,583)	\$ 3,626,508	\$ (159,589)	\$ 3,562,352	3.6%

	December 31, 2012						Net Weighted Average Coupon (1)
	Principal Balance	Unamortized Premium (Discount), net	Discount Designated as Credit Reserve and OTTI	Amortized Cost	Unrealized Gain (Loss), net	Estimated Fair Value	
Agency RMBS:							
20-Year Mortgage	\$ 299,251	\$ 20,460	\$	\$ 319,711	\$ (827)	\$ 318,884	3.2%
30-Year Mortgage	4,180,104	352,378		4,532,482	17,489	4,549,971	3.7%
CMO Fixed rate	66,000	9,776		75,776	(1,546)	74,230	6.5%
Agency Interest-Only Strips							
	N/A	N/A		176,093	(1,057)	175,036	4.5%(2)
Agency Interest-Only Strips, accounted for as derivatives (3)							
	N/A	N/A		N/A	N/A	75,387	4.9%(2)
Non-Agency RMBS	37,372	(5,511)	(12,659)	19,202	(129)	19,073	0.5%
Total	\$ 4,582,727	\$ 377,103	\$ (12,659)	\$ 5,123,264	\$ 13,930	\$ 5,212,581	3.9%

(1) Net weighted average coupon as of September 30, 2013 and December 31, 2012 is presented, net of servicing and other fees.

(2) Agency and Non-Agency Interest-Only Strips, accounted for as derivatives and CMBS Interest-Only Strips have no principal balances and earn contractual interest based on a notional balance. The notional balance is used solely to determine interest distributions on interest-only class of securities.

(3) Interest on these securities is reported as a component of Gain (loss) on derivative instruments, net on the Statement of Operations.

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As of September 30, 2013 the weighted average expected remaining term to maturity of the investment portfolio is 8.8 years.

The components of the carrying value of the Company's investment portfolio are as follows:

	September 30, 2013	December 31, 2012
Principal balance	\$ 3,326,064	\$ 4,582,727
Amortized cost of Interest-Only Strips	209,875	176,093
Carrying value of Agency and Non-Agency Interest-Only Strips accounted for as derivatives	95,433	75,387
Unamortized premium	228,775	382,614
Unamortized discount	(63,623)	(5,511)
Discount designated as Credit Reserve and OTTI	(74,583)	(12,659)
Gross unrealized gains	10,578	25,395
Gross unrealized losses	(170,167)	(11,465)
Fair value	\$ 3,562,352	\$ 5,212,581

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The following tables present the changes in the components of the Company's purchase discount and amortizable premium on its Non-Agency RMBS for the three and nine months ended September 30, 2013 (dollars in thousands):

Three months ended September 30, 2013				
	Discount Designated as Credit Reserve and OTTI	Accretable Discount (1)	Amortizable Premium	
Balance at beginning of period	\$ (68,071)	\$ (36,305)	\$	5,543
Accretion of discount		2,284		
Amortization of premium				198
Realized credit losses	144			
Purchases	(12,112)	(47,882)		14
Sales	4,846	20,893		(20)
Net impairment losses recognized in earnings	(319)			
Unlinking of Linked Transactions	(1,497)	(2,227)		
Transfers/release of credit reserve	2,426	(1,975)		(451)
Balance of end of period	\$ (74,583)	\$ (65,212)	\$	5,284

(1) Together with coupon interest, accretable purchase discount is recognized as interest income over the life of the security.

Nine months ended September 30, 2013				
	Discount Designated as Credit Reserve and OTTI	Accretable Discount (1)	Amortizable Premium	
Balance at beginning of period	\$ (12,659)	\$ (5,523)	\$	12
Accretion of discount		4,433		
Amortization of premium				858
Realized credit losses	386			
Purchases	(125,035)	(82,185)		22,374
Sales	78,959	30,327		(20,669)
Net impairment losses recognized in earnings	(319)			
Unlinking of Linked Transactions	(21,986)	(6,922)		3,438
Transfers/release of credit reserve	6,071	(5,342)		(729)
Balance of end of period	\$ (74,583)	\$ (65,212)	\$	5,284

(1) Together with coupon interest, accretable purchase discount is recognized as interest income over the life of the security.

The Company did not hold any Non-Agency RMBS for the period from May 15, 2012 (commencement of operations) through September 30, 2012.

The following tables present the gross unrealized losses and estimated fair value of the Company's MBS by length of time that such securities have been in a continuous unrealized loss position at September 30, 2013:

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	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Agency RMBS:						
20-Year Mortgage	689,366	(28,733)			689,366	(28,733)
30-Year Mortgage	2,227,416	(127,042)	61,468	(1,288)	2,288,884	(128,330)
Agency Interest-Only Strips	100,921	(8,473)			100,921	(8,473)
Non-Agency RMBS	127,676	(4,616)			127,676	(4,616)
Agency and Non-Agency CMBS	8,325	(15)			8,325	(15)
Total	3,153,704	(168,879)	61,468	(1,288)	3,215,172	(170,167)

At September 30, 2013, the Company did not intend to sell any of its MBS that were in an unrealized loss position, and it is more likely than not that the Company will not be required to sell these MBS before recovery of their amortized cost basis, which may be at their maturity.

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The Company assesses its Agency MBS and Non-Agency MBS, excluding Interest-Only Strips, rated AA and higher at the time of purchase for other-than-temporary impairment on at least a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either temporary or other-than-temporary. In deciding on whether or not a security is other than temporarily impaired, the Company considers several factors, including the nature of the investment, communications (if any) from the trustees of securitizations regarding the credit quality of the security, the severity and duration of the impairment, the cause of the impairment, and the Company's intent that not to sell the security and that it is more likely than not that the Company will not be required to sell the security until recovery of its amortized cost basis. In addition, an other-than-temporary impairment is deemed to have occurred when there is an adverse change in the expected cash flows (principal or interest) to be received and the fair value of the security is less than its carrying amount. In determining whether an adverse change in cash flows occurred, the present value of the remaining cash flows, as estimated at the initial transaction date (or the last date previously revised), is compared to the present value of the expected cash flows at the current reporting date. The estimated cash flows reflect those a market participant would use and are discounted at a rate equal to the current yield used to accrete interest income. These adjustments are reflected in the Company's Statement of Operations as Other loss on Mortgage-backed securities.

For Non-Agency MBS that rated below AA at the time of purchase and Agency and Non-Agency Interest-Only Strips that are not classified as derivatives, an other-than-temporary impairment is deemed to have occurred when there is an adverse change in the expected cash flows (principal or interest) to be received and the fair value of the beneficial interest is less than its carrying amount. These adjustments are reflected in the Company's Statement of Operations as Other loss on Mortgage-backed securities. In determining whether an adverse change in cash flows occurred, the present value of the remaining cash flows, as estimated at the initial transaction date (or the last date previously revised), is compared to the present value of the expected cash flows at the current reporting date. The estimated cash flows reflect those a market participant would use and are discounted at a rate equal to the current yield used to accrete interest income. If an other-than-temporary impairment is recognized as a result of this analysis, the yield is maintained at the current accretion rate. The last revised estimated cash flows are then used for future impairment analysis purposes. The Company's prepayment speed estimate is the primary assumption used to determine other-than temporary-impairments for Interest-Only Strips, including Agency and Non-Agency Interest-Only Strips accounted for as derivatives, for the three and nine months ended September 30, 2013 and for the period from May 15, 2012 (commencement of operations) through September 30, 2012.

The Company recorded other than temporary impairments for the three and nine months ended September 30, 2013 of approximately \$2.0 million and \$7.8 million, respectively and approximately \$1.4 million and \$1.4 million for the three months ended September 30, 2012 and for the period from May 15, 2012 (commencement of operations) through September 30, 2012, respectively, for Agency IOs, Agency IIOs and 20-year Agency RMBS. The Company recorded approximately \$319 thousand of other than temporary impairments for the three and nine months ended September 30, 2013 and \$0 for the three months ended September 30, 2012 and for the period from May 15, 2012 (commencement of operations) through September 30, 2012, respectively for Non-Agency MBS. Other than temporary impairment is reported as Other loss on Mortgage-backed securities in the Company's Statement of Operations.

The following tables present components of interest income on the Company's MBS (dollars in thousands).

For the three months ended September 30, 2013				
	Coupon Interest	Net (Premium Amortization/ Amortization Basis)	Discount Amortization	Interest Income
Agency RMBS	\$ 41,993	\$ (14,777)	\$	27,216
Non-Agency RMBS	934	2,482	\$	3,416
Agency and Non-Agency CMBS	8	14	\$	22

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Total \$ 42,935 \$ (12,281) \$ 30,654

For the nine months ended September 30, 2013

		Net (Premium Amortization/ Amortization Basis)		
	Coupon Interest	Discount Amortization	Interest Income	
Agency RMBS	\$ 138,300	\$ (48,506)	\$ 89,794	
Non-Agency RMBS	2,039	5,291	7,330	
Agency and Non-Agency CMBS	8	14	22	
Total	\$ 140,347	\$ (43,201)	\$ 97,146	

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For the three months ended September 30, 2012, as Revised (See Note 2)

			Net (Premium Amortization/ Amortization Basis) Discount Amortization		Interest Income
	Coupon Interest				
Agency RMBS	\$ 20,547	\$ (7,560)	\$ 12,987		
Total	\$ 20,547	\$ (7,560)	\$ 12,987		

**For the period from May 15, 2012 (commencement of operations)
through September 30, 2012, as Revised (See Note 2)**

			Net (Premium Amortization/ Amortization Basis) Discount Amortization		Interest Income
	Coupon Interest				
Agency RMBS	\$ 29,459	\$ (9,389)	\$ 20,070		
Total	\$ 29,459	\$ (9,389)	\$ 20,070		

The following tables present the sales of the Company's MBS (dollars in thousands).

For the three months ended September 30, 2013

	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency RMBS	\$ 652,521	\$	\$ (47,036)	\$ (47,036)
Non-Agency RMBS	30,256	894		894
Total	\$ 682,777	\$ 894	\$ (47,036)	\$ (46,142)

For the nine months ended September 30, 2013

	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency RMBS				
(1)	\$ 2,798,409	\$ 8,646	\$ (77,903)	\$ (69,257)
Non-Agency RMBS	97,440	5,273		5,273
Total	\$ 2,895,849	\$ 13,919	\$ (77,903)	\$ (63,984)

(1) Includes proceeds for Agency Interest-Only Strips, accounted for as derivatives, of approximately \$8.4 million and gross realized losses of \$99 thousand.

For the three months ended September 30, 2012, as Revised (See Note 2)

	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency RMBS	\$ 657,463	\$ 7,409	\$ (774)	\$ 6,635
Other Securities				
Total	\$ 657,463	\$ 7,409	\$ (774)	\$ 6,635

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For the period from May 15, 2012 (commencement of operations) through
September 30, 2012, as Revised (See Note 2)

	Proceeds		Gross Gains		Gross Losses		Net Gain (Loss)
Agency RMBS	\$	896,335	\$	8,391	\$	(798)	\$ 7,593
Other Securities		100,854		199			199
Total	\$	997,189	\$	8,590	\$	(798)	\$ 7,792

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Note 6 Borrowings under Repurchase Agreements

As of September 30, 2013, the Company had master repurchase agreements with 18 counterparties. As of September 30, 2013, the Company had borrowings under repurchase agreements with 17 counterparties. For the three and nine months ended September 30, 2013, the Company had average borrowings under its repurchase agreements of approximately \$3.6 billion and \$4.1 billion, respectively, had a maximum month-end balance during the three and nine months ended of approximately \$4.0 billion and \$4.8 billion, respectively and accrued interest payable of approximately \$1.8 million. For the three months ended September 30, 2012 and the period from May 15, 2012 (commencement of operations) through September 30, 2012, the Company had average borrowings under its repurchase agreements of approximately \$1.8 billion and \$1.7 billion, respectively, had a maximum month-end balance during the periods of approximately \$1.9 billion and \$1.9 billion, respectively and accrued interest payable of approximately \$737 thousand.

The repurchase agreements bear interest at a contractually agreed-upon rate and typically have terms ranging from one month to three months. The Company's repurchase agreement borrowings are accounted for as secured borrowings when the Company maintains effective control of the financed assets. Under the repurchase agreements, the respective lender retains the right to determine the fair value of the underlying collateral. A reduction in the value of pledged assets requires the Company to post additional securities as collateral, pay down borrowings or establish cash margin accounts with the counterparties in order to re-establish the agreed-upon collateral requirements, referred to as margin calls. The inability of the Company to post adequate collateral for a margin call by the counterparty, in a timeframe as short as the close of the same business day, could result in a condition of default under the Company's repurchase agreements, thereby enabling the counterparty to liquidate the collateral pledged by the Company, which may have a material adverse effect on the Company's financial position, results of operations and cash flows. The volatility in both the Agency and Non-Agency MBS markets during the three months ended September 30, 2013, necessitated the Company being required to post additional collateral with respect to its repurchase agreements. The Company was able to satisfy the requirement for incremental collateral by utilizing unpledged assets and cash on hand. In addition, during the three and nine months ended September 30, 2013, the Company also pledged U.S. Treasury securities it received from its interest rate swap counterparties as incremental collateral in order to generate additional cash proceeds in order to satisfy such margin requirements. At September 30, 2013, the Company did not have any pledged U.S. Treasury securities.

Continued volatility in these markets may create additional stress on the overall liquidity of the Company due to the long-term nature of its assets and the short-term nature of its liabilities. In an instance of severe volatility, or where the additional stress on liquidity resulting from volatility is sustained over an extended period of time, the Company could be required to sell securities, possibly even at a loss, to generate sufficient liquidity to satisfy collateral and margin requirements which could have a material adverse effect on the Company's financial position, results of operations and cash flows. All of the Company's repurchase agreement counterparties are either U.S. financial institutions or the U.S. broker-dealer subsidiaries of foreign financial institutions.

Further, if the Company is unable to renew, replace or expand repurchase financing with other sources of financing on substantially similar terms it may have a material adverse effect on the Company's financial position, results of operations and cash flows, due to the long term nature of the Company's investments and relatively short-term maturities of the Company's repurchase agreements. The financial covenants of certain of the repurchase agreements require the Company to maintain certain equity and leverage metrics, the most restrictive of which include a limit on leverage based on the composition of the Company's portfolio. The Company is in compliance with these covenants.

The following tables summarize certain characteristics of the Company's repurchase agreements at September 30, 2013 and December 31, 2012 (dollars in thousands):

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Securities Pledged	Repurchase Agreement Borrowings	September 30, 2013 Weighted Average Interest Rate on Borrowings Outstanding at end of period	Weighted Average Remaining Maturity (days)
Agency RMBS	\$ 3,149,124	0.42%	36
Non-Agency RMBS	145,061	1.73%	23
Agency and Non-Agency CMBS	14,685	1.40%	69
Total	\$ 3,308,870	0.48%	36

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Securities Pledged	Repurchase Agreement Borrowings	December 31, 2012 Weighted Average Interest Rate on Borrowings Outstanding at end of period	Weighted Average Remaining Maturity (days)
Agency RMBS	\$ 4,794,730	0.48%	19
Total	\$ 4,794,730	0.48%	19

At September 30, 2013, repurchase agreements collateralized by MBS had the following remaining maturities.

(dollars in thousands)	Balance
Overnight	\$ 7,695
2 to 29 days	1,648,987
30 to 59 days	803,968
60 to 89 days	834,760
90 to 119 days	13,460
Greater than or equal to 120 days	
Total	\$ 3,308,870

As discussed in Note 3, for any transactions determined to be linked, the initial transfer and repurchase financing will be recorded as a forward commitment to purchase assets. At September 30, 2013, the Company had no repurchase agreements that were accounted for as linked transactions, but did have linked transactions during the three and nine month periods ended September 30, 2013. At December 31, 2012, the Company had no transactions determined to be linked. These linked repurchase agreements would not be included in the above tables. See Note 8 for details.

At September 30, 2013, the following table reflects amounts at risk under its repurchase agreements greater than 10% of the Company's equity with any counterparty.

Counterparty	September 30, 2013 (dollars in thousands)		
	Amount at Risk, at fair value	Weighted Average Remaining Maturity (days)	Percentage of Stockholders Equity
Barclays Capital Inc.	\$ 68,980	60	16.9%
JP Morgan Securities LLC	63,101	12	15.4
Credit Suisse Securities (USA) LLC	47,954	51	11.7

Note 7 Collateral Positions

The following tables summarize the Company's collateral positions, with respect to its borrowings under repurchase agreements, derivatives and clearing margin account at September 30, 2013 and December 31, 2012 (dollars in thousands):

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	September 30, 2013		
	Assets Pledged- Fair Value	Accrued Interest	Fair Value of Assets Pledged and Accrued Interest
Assets pledged for borrowings under repurchase agreements:			
Agency RMBS	\$ 3,402,366	\$ 12,781	\$ 3,415,147
Non-Agency RMBS	214,321	169	214,490
Agency and Non-Agency CMBS	17,622	103	17,725
Cash (1)	2,393		2,393
Cash collateral for derivatives (1):	41,723		41,723
Total	\$ 3,678,425	\$ 13,053	\$ 3,691,478

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	December 31, 2012		
	Assets Pledged - Fair Value	Accrued Interest, as Revised(2)	Fair Value of Assets Pledged and Accrued Interest, as Revised(2)
Assets pledged for borrowings under repurchase agreements:			
Agency RMBS	\$ 5,043,824	\$ 15,552	\$ 5,059,376
Cash (1)	35,982		35,982
Cash collateral for derivatives (1):	18,160		18,160
Total	\$ 5,097,966	\$ 15,552	\$ 5,113,518

- (1) Cash posted as collateral is included in Due from counterparties on the Company's Balance Sheets.
- (2) The accrued interest related to Agency RMBS was incorrectly disclosed as \$67,551 in prior disclosure, and has been revised above.

A reduction in the value of pledged assets typically results in the repurchase agreement counterparties, derivative counterparties and clearing margin counterparties initiating a daily margin call. At September 30, 2013 and December 31, 2012, MBS held by counterparties as security for repurchase agreements totaled approximately \$3.6 billion and \$5.0 billion, respectively. The collateral held by each of the counterparties was in excess of 5% of the Company stockholders' equity. Cash collateral held by counterparties at September 30, 2013 and December 31, 2012 was approximately \$44.1 and \$54.1 million, respectively. In addition, at September 30, 2013, December 31, 2012, and September 30, 2012, the Company held securities of approximately \$11.7 million, \$2.6 million and \$16.8 million, respectively, received as collateral from its repurchase agreement counterparties to satisfy margin requirements.

Note 8 Derivative Instruments

The Company's derivatives currently include interest rate swaps (interest rate swaps), interest rate swaptions, TBAs, linked transactions, Agency and Non-Agency Interest-Only Strips that are classified as derivatives, and options.

Interest rate swaps and interest rate swaptions

The Company is exposed to certain risks arising from both its business operations and economic conditions. Specifically, the Company's primary source of debt funding is repurchase agreements and the Company enters into derivative financial instruments to manage exposure to variable cash flows on portions of its borrowings under those repurchase agreements. Since the interest rates on repurchase agreements typically change with market interest rates such as LIBOR, the Company is exposed to constantly changing interest rates, which accordingly affects cash flows associated with these rates on its borrowings. To mitigate the effect of changes in these interest rates, the Company enters into interest rate swap agreements which help to mitigate the volatility in the interest rate exposures and their related cash flows. Interest rate swaps generally involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the interest rate swap without exchange of the underlying notional amount.

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While the Company has not elected to account for its interest rate swap derivative instruments as hedges under GAAP, it does not use interest rate swaps and swaptions for speculative purposes, but rather uses such instruments to manage interest rate risk and views them as economic hedges. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly in earnings together with or including periodic net interest settlement amounts.

The Company's interest rate swaps, interest rate swaptions, TBA derivative instruments and linked transactions consisted of the following at September 30, 2013 and December 31, 2012 (dollars in thousands):

Derivative Instrument	Designation	Balance Sheet Location	Notional Amount	September 30, 2013	
				Fair Value, excluding accrued interest	Accrued Interest Payable
Interest rate swaps, assets	Non-Hedge	Derivative assets, at fair value	\$ 1,369,450	\$ 60,854	\$ 2,534
TBA securities, assets	Non-Hedge	Derivative assets, at fair value	250,000	977	
Total derivative instruments, assets			1,619,450	61,831	2,534
Interest rate swaps, liability	Non-Hedge	Derivative liability, at fair value	1,364,400	(9,036)	2,765
TBA securities, liabilities	Non-Hedge	Derivative liability, at fair value	140,000	(66)	
Total derivative instruments, liabilities			1,504,000	(9,102)	2,765
Total derivative instruments			\$ 3,123,850	\$ 52,729	\$ 5,299

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Derivative Instrument	Designation	Balance Sheet Location	Notional Amount	December 31, 2012 Fair Value, excluding accrued interest	Accrued Interest Payable
Interest rate swaps, assets	Non-Hedge	Derivative assets, at fair value	\$ 1,827,300	\$ 11,201	\$ 2,519
Interest rate swaptions, assets	Non-Hedge	Derivative assets, at fair value	520,000	10,087	
TBA securities, assets	Non-Hedge	Derivative assets, at fair value	425,000	3,056	
Total derivative instruments, assets			2,772,300	24,344	2,519
Interest rate swaps, liabilities	Non-Hedge	Derivative liability, at fair value	984,500	(3,552)	588
TBA securities, liabilities	Non-Hedge	Derivative liability, at fair value	425,000	(1,219)	
Total derivative instruments, liabilities			1,409,500	(4,771)	588
Total derivative instruments			\$ 4,181,800	\$ 19,573	\$ 3,107

The following tables summarize the average fixed pay rate and average maturity for the Company's interest rate swaps as of September 30, 2013 and December 31, 2012 (excludes interest rate swaptions) (dollars in thousands):

Remaining Interest Rate	interest rate swap Term	Notional Amount	September 30, 2013		
			Average Fixed Pay Rate	Average Maturity (Years)	Forward Starting
Greater than 1 year and less than 3 years		\$ 395,000	0.4%	1.6	37.7%
Greater than 3 years and less than 5 years		482,600	1.3	4.6	
Greater than 5 years		1,856,250	2.3	11.1	32.2
Total		\$ 2,733,850	1.9%	8.6	27.3%

Remaining Interest Rate	interest rate swap Term	Notional Amount	December 31, 2012		
			Average Fixed Pay Rate	Average Maturity (Years)	Forward Starting
Greater than 1 year and less than 3 years		\$ 762,800	0.4%	2.3	22.7%
Greater than 3 years and less than 5 years		439,500	0.8	4.8	10.2
Greater than 5 years		1,609,500	1.7	10.2	30.1
Total		\$ 2,811,800	1.2%	7.2	25.0%

The Company's agreements with certain of its interest rate swap counterparties may be terminated at the option of the counterparty if the Company does not maintain certain equity and leverage metrics, the most restrictive of which contain provisions which become more restrictive based upon portfolio composition. Through September 30, 2013, the Company was in compliance with the terms of such financial tests.

The Company has minimum collateral posting thresholds with certain of its derivative counterparties, for which it typically pledges cash. As of September 30, 2013 and December 31, 2012, the Company had cash pledged as collateral of approximately \$41.7 million and \$18.2 million,

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respectively, which is reported on the Balance Sheets as Due from counterparties. The Company received cash of approximately \$38.0 million and \$0 as collateral against derivatives at September 30, 2013 and December 31, 2012, respectively. As of September 30, 2013, the Company has swaps with two counterparties that are based in England and Switzerland with fair values in an asset position of approximately \$14.7 million and \$25.5 million and notional balances of \$321.8 million and \$825.1 million, respectively. Included in the \$38.0 million received by the Company is cash posted as collateral by these two counterparties of approximately \$28.5 million at September 30, 2013. At December 31, 2012, the Company posted approximately \$6.6 million cash as collateral to these two counterparties.

Interest-Only Strips

The Company also invests in Interest-Only Strips. In determining the classification of its Interest-Only Strips, the Company evaluates the securities to determine if the nature of the cash flows has been altered from that of the underlying mortgage collateral. Generally, Interest-Only Strips for which the security represents a strip off of a mortgage pass through will be considered a hybrid instrument classified as a MBS investment on the Balance Sheet utilizing the fair value option. Alternatively, those Interest-Only Strips, for which the underlying mortgage collateral has been included into a structured security that alters the cash flows from the underlying mortgage collateral, are accounted for as derivatives at fair value with changes recognized in Gain (loss) on derivative instruments, net in the Statement of Operations, along with any interest received. The carrying value of these Interest-Only Strips is included in Mortgage-backed securities on the Balance Sheet.

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To-be-announced securities

The Company also purchased or shorted TBAs. As of September 30, 2013 and December 31, 2012, the Company had contracts to purchase (long position) and sell (short position) TBAs on a forward basis. Following is a summary of the Company's long and short TBA positions reported in Derivative assets, at fair value on the Balance Sheets as of September 30, 2013 and December 31, 2012 (dollars in thousands):

	September 30, 2013		December 31, 2012	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Purchase contracts, asset	\$ 250,000	\$ 977	\$ 425,000	\$ 3,056
TBA securities, asset	250,000	977	425,000	3,056
Purchase contracts, liability	140,000	(66)		
Sale contracts, liability			(425,000)	(1,219)
TBA securities, liability	140,000	(66)	(425,000)	(1,219)
TBA securities, net	\$ 390,000	\$ 911	\$	\$ 1,837

	Notional Amount as of December 31, 2012	Additions	Settlement, Termination, Expiration or Exercise	Notional Amount as of September 30, 2013
	Purchase of TBAs	\$ 425,000	2,164,000	\$ (2,199,000)
Sale of TBAs	\$ 425,000	2,350,000	\$ (2,775,000)	\$

Gain (loss) on derivative instruments

The following tables summarize the effect of interest rate swaps, swaptions, options, Agency and Non-Agency Interest-Only Strips as derivatives and TBAs reported in Gain (loss) on derivative instruments, net on the Company's Statement of Operations for the three and nine months ended September 30, 2013, for the three months ended September 30, 2012 and for the period from May 15, 2012 (commencement of operations) through September 30, 2012 (dollars in thousands):

Description	Realized Gain (Loss), net	Three months ended September 30, 2013				Total
		Contractual interest income (expense), net(1)	Basis Recovery	Mark-to-market adjustments		
Interest rate swaps	\$ 23,166	\$ (6,158)	\$	\$ (28,891)	\$ (11,883)	
Interest rate swaptions	22,633			(16,065)	6,568	
Agency and Non-Agency Interest-Only Strips accounted for as derivatives		6,993	(4,040)	(4,824)	(1,871)	
TBAs	1,016			2,361	3,377	
Total	\$ 46,815	\$ 835	\$ (4,040)	\$ (47,419)	\$ (3,809)	

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Description	Nine months ended September 30, 2013				
	Realized Gain (Loss), net	Contractual interest income (expense), net(1)	Basis Recovery	Mark-to-market adjustments	Total
Interest rate swaps	\$ 65,305	\$ (15,896)	\$	\$ 44,169	\$ 93,578
Interest rate swaptions	23,671			3,180	26,851
Agency and Non-Agency Interest-Only Strips accounted for as derivatives	(99)	19,968	(12,856)	(3,539)	3,474
Options	(925)				(925)
TBAs	(1,547)			(926)	(2,473)
Total	\$ 86,405	\$ 4,072	\$ (12,856)	\$ 42,884	\$ 120,505

Description	For the three months ended September 30, 2012, as Revised (See Note 2)				
	Realized Gain (Loss), net	Contractual interest income (expense), net(1)	Basis Recovery	Mark-to-market adjustments	Total
Interest rate swaps	\$	\$ (1,630)	\$	\$ (8,075)	\$ (9,705)
Interest rate swaptions				(298)	(298)
Agency Interest-Only Strips accounted for as derivatives		2,619	(1,888)	(2,973)	(2,242)
Options					
TBAs					
Total	\$	\$ 989	\$ (1,888)	\$ (11,346)	\$ (12,245)

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For the period from May 15, 2012 (commencement of operations) through September 30, 2012, as Revised (See Note 2)

Description	Realized Gain (Loss), net	Contractual interest income (expense), net(1)	Basis Recovery	Mark-to- market adjustments	Total
Interest rate swaps	\$ 4	\$ (2,356)	\$	\$ (13,119)	\$ (15,471)
Interest rate swaptions				(298)	(298)
Agency Interest-Only Strips accounted for as derivatives		3,573	(2,010)	(3,198)	(1,635)
Options					
TBAs					