Two Harbors Investment Corp.
Form S-11/A
April 07, 2010

As filed with the Securities and Exchange Commission on April 6, 2010

Registration Statement No. 333-165556

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

AMENDMENT NO. 1
TO
FORM S-11

FOR REGISTRATION
UNDER THE SECURITIES ACT OF 1933
OF SECURITIES OF CERTAIN REAL ESTATE
COMPANIES

Two Harbors Investment Corp.

(Exact Name of Registrant As Specified in Its Governing Instruments)

601 Carlson Parkway, Suite 330
Minnetonka, Minnesota 55305
(612) 238-3300

(Address, Including Zip Code, and Telephone Number,
Including Area Code, of Registrant s Principal Executive Offices)

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Approximate date of commencement of proposed sale to the public: From time to time after the effective date of this registration statement.

If any of the Securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, check the following box: o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non accelerated filer, or a smaller reporting company. See 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 o	Accelerated Filer o	Non-Accelerated Filer x (Do not check if a smaller reporting company)	Smaller Reporting Company o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Security Being Registered	Proposed Maximum Aggregate Offering Price(1)	Amount of Registration Fee(2)
Common Stock, par value $.0.01 per share	$150,000,000.00	$10,695(3)

(1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(o) under the Securities Act.

(2) Calculated in accordance with Rule 457(o) under the Securities Act of 1933, as amended.

(3) Previously paid.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED APRIL 6, 2010

14,000,000 Shares

Two Harbors Investment Corp.

Common Stock

We are selling 14,000,000 shares of common stock.

Our common stock is listed on the NYSE Amex under the symbol TWO . The closing price on the NYSE Amex on April 5, 2010, was $9.09 per share.

The underwriters have an option to purchase a maximum of 2,100,000 additional shares to cover over-allotments of shares.

We intend to elect and qualify to be taxed as a real estate investment trust for U.S. federal income tax purposes, commencing with our taxable year ending December 31, 2009. To assist us in qualifying as a real estate investment trust, among other purposes, stockholders are generally restricted from owning more than 9.8% by value or number of shares, whichever is more restrictive, of our outstanding shares of common stock. In addition, our charter contains various other restrictions on the ownership and transfer of our common stock. See Description of Capital Stock Restrictions on Ownership and Transfer.

Investing in our common stock involves risks. See Risk Factors on page 16.

	Price to Public	Underwriting Discounts and Commissions	Proceeds to Us
Per Share	$	$	$
Total	$	$	$

Delivery of the shares of common stock will be made on or about , 2010.

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

Credit Suisse

Barclays Capital	**JMP Securities**	**Keefe, Bruyette & Woods**
Ladenburg Thalmann & Co. Inc.		**Sterne Agee**

The date of this prospectus is , 2010.

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TWO HARBORS INVESTMENT CORP.

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You should rely only on the information contained in this document or to which we have referred you. We have not authorized anyone to provide you with information that is different. This document may only be used where it is legal to sell these securities. The information in this document may only be accurate on the date of this document.

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SUMMARY

This summary highlights some of the information in this prospectus. It does not contain all of the information that you should consider before investing in our common stock. You should read carefully the more detailed information set forth under Risk Factors and the other information included in this prospectus. Except where the context suggests otherwise, the terms Two Harbors, we, our, and us refer to Two Harbors Investment Corp., a Maryland corporatio together with its consolidated subsidiaries.

Our Company

We are a Maryland corporation focused on investing in, financing and managing residential mortgage-backed securities, or RMBS, and related investments, which we collectively refer to as our target assets. We intend to qualify as a real estate investment trust, or REIT, as defined under the Internal Revenue Code of 1986, as amended, or the Code.

We are externally managed by PRCM Advisers LLC. PRCM Advisers LLC is a wholly-owned subsidiary of our sponsor, Pine River Capital Management L.P., which we refer to as Pine River, a global multi-strategy asset management firm with an established track record of investing in our target assets and fixed income securities.

Our objective is to provide attractive risk-adjusted returns to our stockholders over the long term, primarily through dividends and secondarily through capital appreciation. We selectively acquire and manage an investment portfolio of our target assets, which is constructed to generate attractive returns through market cycles. We focus on security selection and implement a relative value investment approach across various sectors within the residential mortgage market. Our target assets include the following:

Agency RMBS, meaning RMBS whose principal and interest payments are guaranteed by the Government National Mortgage Association (or Ginnie Mae), the Federal National Mortgage Association (or Fannie Mae), or the Federal Home Loan Mortgage Corporation (or Freddie Mac),

Non-Agency RMBS, meaning RMBS that are not issued or guaranteed by Ginnie Mae, Fannie Mae or Freddie Mac, and

Financial assets other than RMBS, comprising approximately 5% to 10% of the portfolio.

We seek to deploy moderate leverage as part of our investment strategy. We generally finance our target assets through short-term borrowings structured as repurchase agreements. We may also finance portions of our portfolio through non-recourse term borrowing facilities and equity financing provided by government programs, if such financing becomes available.

We recognize that investing in our target assets is competitive and that we compete with other investment vehicles for attractive investment opportunities. We rely on our management team and Pine River, who have developed strong relationships with a diverse group of financial intermediaries. In addition, we have benefited and expect to continue to benefit from Pine River s analytical and portfolio management expertise and infrastructure. We believe that our significant focus on the RMBS area, the extensive RMBS expertise of our investment team, our strong analytics and our disciplined relative value investment approach give us a competitive advantage versus our peers.

We commenced operations on October 28, 2009, upon completion of a merger with Capitol Acquisition Corp., or Capitol. At the closing of the merger, after deducting transaction costs and expenses and payments to Capitol stockholders, we had approximately $124 million in cash available to fund investments and operations.

We intend to elect and qualify to be taxed as a REIT for U.S. federal income tax purposes, commencing with our initial taxable period ended December 31, 2009. To qualify as a REIT we will be required to meet certain investment and operating tests and annual distribution requirements. We generally will not be subject to U.S. federal income taxes on our taxable income to the extent that we annually distribute all of our net taxable income to stockholders and maintain our intended qualification as a REIT. However, certain activities that we may perform may cause us to earn income which will not be qualifying income for REIT purposes. We have preserved Capitol as a taxable REIT subsidiary, or TRS, as defined in the Code, to engage in such

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activities, and we may in the future form additional TRSs. We also intend to operate our business in a manner that will permit us to maintain our exemption from registration under the Investment Company Act of 1940, as amended, or the 1940 Act.

Our Manager

We are externally managed and advised by PRCM Advisers LLC, a wholly-owned subsidiary of Pine River. Founded in 2002, with offices in New York, London, Hong Kong, San Francisco and Minnetonka, Minnesota, Pine River is a global multi-strategy asset management firm providing comprehensive portfolio management, transparency and liquidity to institutional and high net worth investors.

Pine River formed PRCM Advisers LLC for the purpose of providing management services to us. PRCM Advisers LLC is responsible for administering our business activities and day-to-day operations. Pursuant to the terms of a management agreement between us and PRCM Advisers LLC, PRCM Advisers LLC provides us with our management team, including our officers, along with appropriate support personnel. In addition, PRCM Advisers LLC provides us with the expertise of Pine River s fixed income team, proprietary analytical tools and appropriate fund infrastructure. PRCM Advisers LLC is at all times subject to the supervision and oversight of our board of directors. Each of our officers is an employee or partner of Pine River. We do not have any employees. We do not pay any of our officers any cash compensation. Rather, we pay PRCM Advisers LLC a 1.5% annual base management fee pursuant to the terms of the management agreement and the allocable share of the compensation paid by PRCM Advisers LLC to its personnel serving as our principal financial officer and general counsel and other reimbursable costs under the management agreement and shared facilities and services agreement. We do not pay PRCM Advisers LLC any incentive-based fees or other incentive-based compensation.

Through our relationship with PRCM Advisers LLC, we benefit from Pine River s disciplined and highly analytical investment approach, extensive long-term relationships in the financial community, and established infrastructure. Pine River s disciplined investment approach utilizes a cross-product approach, conducting top-down market assessments with respect to various subsets of the RMBS market in order to identify the most attractive segments and investment opportunities. Our security selection process leverages proprietary and third party analytic tools to conduct a detailed analysis of factors that influence our target assets. We select our RMBS based on factors that include extensive analysis of the underlying loans, including prepayment trends, average remaining life, amortization schedules, fixed versus floating interest rates, geographic concentration, property type, loan-to-value ratios and credit scores.

Pine River s fixed income team has broad experience in managing Agency RMBS, non-Agency RMBS and other mortgage-related assets through a variety of credit and interest rate environments and has demonstrated the ability to generate attractive risk-adjusted returns under different market conditions and cycles, on both a levered and unlevered basis. Pine River maintains extensive long-term relationships with financial intermediaries including prime brokers, investment banks, broker-dealers and asset custodians. These relationships enhance PRCM Advisers LLC s ability to source, finance, protect and hedge our investments and, thus, enable us to succeed in various credit and interest rate environments. We also benefit from Pine River s comprehensive finance, operational and administrative infrastructure, including its risk management and accounting operations, as well as its legal, compliance and software development teams.

As of December 31, 2009, Pine River had net assets under management, including the Two Harbors stockholders equity of approximately $122 million, of approximately $1.5 billion, of which approximately $650 million is dedicated to mortgage strategies. Pine River employed 67 employees globally, including 24 investment professionals, and has successfully maintained low employee attrition.

Our Investment Strategy

Our objective is to provide attractive risk-adjusted returns to our stockholders over the long-term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by constructing a well-balanced portfolio consisting primarily of RMBS, with a focus on managing various associated risks, including interest rate, prepayment, mortgage spread and financing risk. Consistent with the objective of achieving attractive risk-adjusted returns over various market cycles, PRCM Advisers LLC intends to maintain a balanced approach to these various risks.

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We rely on PRCM Advisers LLC s expertise in identifying assets within our target asset classes. PRCM Advisers LLC makes investment decisions based on a rigorous security selection process that takes into consideration a variety of factors, including expected cash yield, risk-adjusted returns, current and projected credit fundamentals, current and projected macroeconomic considerations, current and projected supply and demand, credit and market risk concentration limits, liquidity, cost of financing and financing availability. In all cases, we select securities in such a way as to maintain our REIT qualification and our exemption from registration under the 1940 Act.

Our Investments

Our Target Assets

Our target asset classes and the principal investments we have made and expect to make are as follows:

Agency RMBS	Agency RMBS collateralized by either fixed rate mortgage loans, adjustable rate mortgage loans or hybrid mortgage loans, or derivatives thereof, including:
	mortgage pass-through certificates;
	collateralized mortgage obligations;
	Freddie Mac certificates;
	Fannie Mae certificates;
	Ginnie Mae certificates;
	to-be-announced forward contracts; and
	interest-only and inverse interest-only securities.
Non-Agency RMBS	Non-Agency RMBS collateralized by prime mortgage loans, Alt-A mortgage loans and subprime mortgage loans, which may have fixed rate, adjustable rate or hybrid rate terms. Non-Agency RMBS includes both senior and mezzanine RMBS. Senior RMBS refers to non-Agency RMBS that represent the senior-most tranches that is, the tranches which have the highest priority claim to cash flows from the related collateral pool, within the RMBS structure. Mezzanine RMBS refers to subordinated tranches within the collateral pool. The non-Agency RMBS we

	purchase may include investment-grade and non-investment grade classes, including non-rated securities. Hybrid mortgage loans have terms with interest rates that are fixed for a specified period of time and, thereafter, generally adjust periodically to an increment over a specified interest rate index. ARMs refer to hybrid and adjustable-rate mortgage loans which typically have interest rates that adjust periodically to an increment over a specified interest rate index.
Assets other than RMBS	Non-real estate investments including non-mortgage related securities and certain hedging transactions that may produce non-qualifying income for purposes of the REIT gross income tests.

Our investment portfolio at December 31, 2009 primarily consisted of RMBS. After the consummation of this offering, we expect that our investment portfolio will continue to consist primarily of RMBS, subject to our REIT qualification and our 1940 Act exemption.

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Our Investment Activities

At December 31, 2009, we had total assets of approximately $538.4 million, of which $494.5 million, or 91.8%, represented our RMBS portfolio. At December 31, 2009, $417.8 million, or 84.5% of our RMBS portfolio was comprised of Agency RMBS, $54.1 million, or 10.9% of our RMBS portfolio was comprised of senior non-Agency RMBS, and the remaining $22.6 million, or 4.6% was comprised of other non-Agency RMBS.

Our Investment Portfolio

	As of December 31, 2009		
	Carrying Value	Yield[1]	
Total Agency RMBS	417,820,016	3.2	%
Total Non-Agency RMBS[2]	76,644,851	13.1	%
Total	$ 494,464,867	4.7	%

(1) Actual realized yields will depend on a number of factors that cannot be predicted with certainty, including realized prepayment speeds for Agency RMBS. In addition to prepayment speeds, actual yields will depend on the timing and extent of loan defaults and recoveries for Non-Agency RMBS. Estimated yields do not include any costs of operating or managing Two Harbors and are not an indication of estimated earnings.

(2) As of December 31, 2009, the senior non-agency RMBS totaled $54 million, which were not at target asset levels of approximately $75.0 million.

Investment Guidelines

Our board of directors has adopted the following investment guidelines:

- no investment shall be made that would cause us to fail to qualify as a REIT for U.S. federal income tax purposes;
- no investment shall be made that would cause us to be regulated as an investment company under the 1940 Act;
- we will primarily invest within our target assets, consisting primarily of Agency RMBS and non-Agency RMBS;
- approximately 5% to 10% of our portfolio may include assets other than RMBS; and
- until appropriate investments can be identified, we will invest available cash in interest-bearing and short-term investments that are consistent with (i) our intention to qualify as a REIT, and (ii) our exemption from investment company status under the 1940 Act.

These investment guidelines may be changed from time to time by our board of directors without the approval of our stockholders.

Within the constraints of the foregoing investment guidelines, PRCM Advisers LLC has broad authority to select, finance and manage our investment portfolio. As a general matter, our investment strategy is designed to enable us to:

- build an investment portfolio consisting of Agency RMBS and non-Agency RMBS that will generate attractive returns while having a moderate risk profile;
- manage financing, interest rate, prepayment rate and credit risks;
- capitalize on discrepancies in the relative valuations in the mortgage market; and
- provide regular quarterly distributions to stockholders.

Within the requirements of the investment guidelines, PRCM Advisers LLC makes determinations as to the percentage of our assets that will be invested in each of our target assets. PRCM Advisers LLC s decisions depend on prevailing market conditions and change over time in response to opportunities available in different interest rate, economic and credit environments. As a result, we cannot predict the percentage of our

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assets that will be invested in any of our target asset classes at any given time. We believe that the diversification of our portfolio of assets and the flexibility of our strategy, combined with PRCM Advisers LLC s and its affiliates expertise, will enable us to achieve attractive risk-adjusted returns under a variety of market conditions and economic cycles.

Our Financing Strategy

We deploy moderate leverage to increase potential returns to our stockholders and to fund the acquisition of our assets. We are not required to maintain any particular leverage ratio. The amount of leverage we deploy for particular investments in our target assets depends upon an assessment of a variety of factors, which may include the anticipated liquidity and price volatility of our assets; the gap between the duration of assets and liabilities, including hedges; the availability and cost of financing the assets; our opinion of the credit worthiness of financing counterparties; the health of the U.S. economy and residential mortgage-related markets; our outlook for the level, slope, and volatility of interest rates; the credit quality of the loans we acquire; the collateral underlying our Agency RMBS and non-Agency RMBS; and our outlook for asset spreads relative to the London Interbank Offered Rate, or LIBOR, curve.

Our primary financing sources are repurchase agreements. We may use repurchase agreements to deploy, on a debt-to-equity basis, up to ten times leverage on our Agency RMBS assets, but we are not required to maintain any particular leverage ratio. We expect under current market conditions to deploy limited leverage on our non-Agency RMBS through the use of repurchase agreements. In the future, we may pursue additional leverage in conjunction with financings that may be available from traditional private sources of lending or under programs established by the U.S. government. In the current economic climate, repurchase lenders generally advance approximately 90% to 95% of the market value of the Agency RMBS financed (meaning a 5% to 10% discount from market value, or haircut) and 50% to 65% of the market value on the non-Agency RMBS financed (meaning a 35% to 50% haircut). A significant decrease in advance rate or an increase in the haircut could result in our having to sell securities in order to meet additional margin requirements by the lender. We expect to mitigate our risk of margin calls by deploying a prudent amount of leverage that is below what could be used under current advance rates.

In order to reduce our exposure to counterparty-related risk, we generally seek to diversify our exposure by entering into repurchase agreements with multiple counterparties. As of April 6, 2010, we had repurchase agreements in place with nine counterparties. At December 31, 2009, we had $411.9 million of outstanding balances under repurchase agreements with six counterparties, with a maximum net exposure (the difference between the amount loaned to us, including interest payable, and the value of the securities pledged by us as collateral, including accrued interest receivable on such securities) to any single lender of $17.3 million.

Interest Rate Hedging and Risk Management Strategy

We enter into derivative financial instruments, or hedging instruments, to hedge all or a portion of the interest rate risk on our LIBOR-based repurchase agreements. At December 31, 2009, our hedging instruments consisted solely of swaps, which are used to lock-in fixed interest rates over the term of the swap, related to a portion of our existing and anticipated future repurchase agreements. At December 31, 2009, we were a party to fixed-rate swaps with an aggregate notional amount of $100.0 million.

Dividend Policy

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

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On December 21, 2009, we declared a dividend of $0.26 per share of common stock to stockholders of record as of December 31, 2009, and paid such dividend on January 26, 2010. On March 12, 2010, we declared a dividend of $0.36 per share of common stock to stockholders of record as of March 31, 2010 and will pay such dividend on April 23, 2010. Investors in this offering will not be entitled to receive this dividend.

Our Competitive Advantages

Our investment strategy is focused on utilizing our underlying core strengths, described below in further detail, which we believe offer competitive advantages in the marketplace:

Significant Experience of Our Management Team

We believe that the extensive experience of our management team and, through our relationship with PRCM Advisers LLC, the officers and employees of Pine River provides us with significant expertise across our target assets. Pine River s fixed income investment team has managed Agency RMBS, non-Agency RMBS and other mortgage-related assets through a variety of credit and interest rate environments and has demonstrated strong ability to generate attractive risk-adjusted returns under different market conditions, on both a levered and unlevered basis.

The senior members of our research and investment team have an average of 22 years of experience in mortgage-backed securities investing, including experience in performing advisory services for investment banks, funds, other investment vehicles, and other managed and discretionary accounts. Our Co-Chief Investment Officers are Steven Kuhn and William Roth. Mr. Kuhn is a Partner of Pine River, and joined the firm in January 2008. He has 16 years of experience investing in RMBS and other fixed income securities for Goldman Sachs Asset Management, Citadel and Cargill. Mr. Roth joined Pine River in June 2009, and has 28 years of experience working for Salomon Brothers and Citigroup in mortgage-backed and asset-backed securities markets. The fixed income investment team also includes seasoned traders, analysts and risk managers, and is backed by Pine River s extensive infrastructure in the areas of credit analysis, trade execution, risk management, valuation, accounting, operations, corporate governance and law.

Disciplined Relative Value Investment Approach

Disciplined security selection is a key element of our strategy. We are, in essence, a relative value investor in mortgage-backed securities. PRCM Advisers LLC uses a cross-product approach, conducting top-down market assessments with respect to various subsets of the RMBS market in order to identify the most attractive segments and investment opportunities. In employing this detailed analysis, PRCM Advisers LLC seeks to best capture market inefficiencies and identify the most mispriced securities. We select our RMBS based on factors that include extensive analysis of the underlying loans, including prepayment trends, average remaining life, amortization schedules, fixed versus floating interest rates, geographic concentration, property type, loan-to-value ratios and credit scores. Considering the multi-trillion dollar size of the U.S. RMBS market, we can be very selective with our investments and buy only the securities we deem to be the most attractive. We believe this holistic, relative-value approach to the non-Agency and Agency RMBS investments may achieve higher risk-adjusted returns than an approach that focuses on a single sector of the residential mortgage market.

Portfolio Construction

Our objective is to provide attractive risk-adjusted returns to our stockholders over the long-term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by constructing a well-balanced portfolio consisting primarily of RMBS, with a focus on managing various associated risks, including interest rate, prepayment, mortgage spread and financing risk. PRCM Advisers LLC uses its fixed income investment team s expertise across a broad range of asset classes within the RMBS markets to build a portfolio that seeks to balance income, cash, capital appreciation, leverage and the aforementioned risks. Through the careful and disciplined selection of assets, and continual portfolio monitoring, we seek to build and maintain an investment portfolio that provides value to stockholders over time both in absolute terms and relative to other RMBS portfolios.

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Access to PRCM Advisers LLC s Analytical Tools, Infrastructure and Expertise

Our experienced investment team constructs and manages our RMBS investment portfolio through the use of focused qualitative and quantitative analysis, which helps us manage risk on a security-by-security and portfolio basis. We rely on a variety of proprietary and third party analytical tools and models, which we customize to our needs. We focus on in-depth analysis of the numerous factors that influence our target assets, including:

- fundamental market and sector review;
- cash flow analysis;
- disciplined security selection;
- controlled risk exposure; and
- prudent balance sheet management.

We also use these tools to guide the hedging strategies developed by PRCM Advisers LLC to the extent consistent with the requirements for qualification as a REIT.

In addition, through PRCM Advisers LLC we have access to Pine River s proprietary technology management platform, called Everest, to track investments and to monitor investment risk across asset classes. Everest collects and stores real-time market data, and integrates market performance with portfolio holdings and proprietary risk models to measure the risk positions in our portfolios. This measurement system portrays overall portfolio risk and risk sources.

Our focus on loan level and local market analysis allows us to track and understand borrower performance, which we consider key in our overall investment strategy. Our ability to track real-time variables such as market specific home prices and unemployment rates provides us with valuable insights and helps with specific asset selection decisions. We believe that sophisticated analysis of both macro- and micro-economic factors will enable us to manage cash flow and distributions while preserving our stockholders capital.

Through a shared facilities and services agreement with Pine River, PRCM Advisers LLC has access to analytical and portfolio management capabilities to aid in security selection and risk management. We capitalize on the market knowledge and ready access to data across our target markets that PRCM Advisers LLC and its affiliates obtain through their established platform. We also benefit, through PRCM Advisers LLC, from Pine River s comprehensive finance, operational and administrative infrastructure, including its risk management and financial reporting and accounting operations, as well as its business development, legal and compliance, operations and settlement and software development teams.

Extensive Strategic Relationships and Experience of PRCM Advisers LLC and its Affiliates

PRCM Advisers LLC and its affiliates maintain extensive long-term relationships with financial intermediaries including prime brokers, investment banks, broker-dealers and asset custodians. We believe these relationships enhance our ability to source, finance, protect and hedge our investments and, thus, enable us to succeed in various credit and interest rate environments. Members of the fixed income investment team have many years of experience and well-established contacts within the RMBS industry, and are able to bring their personal relationships to bear for our benefit and the benefit of our stockholders.

Summary Risk Factors

An investment in shares of our common stock involves various risks. You should consider carefully the risks discussed below and under the heading Risk Factors beginning on page 16 of this prospectus before purchasing our common stock. If any of the following risks occur, our business, financial condition or results of operations could be materially and adversely affected. In that case, the trading price of our common stock could decline, and you may lose some or all of your investment.

We are dependent on PRCM Advisers LLC for our success. In addition, we rely on our financing opportunities relating to our repurchase agreement financings that have been and will be facilitated and/or provided by PRCM Advisers LLC.

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PRCM Advisers LLC has limited experience operating a REIT or managing a portfolio of our target assets on a leveraged basis and we cannot assure you that PRCM Advisers LLC s past experience will be sufficient to successfully manage our business as a REIT with such a portfolio.
We have a limited operating history and may not be able to successfully operate our business or generate sufficient revenue or sustain payment of dividends to our stockholders.
There are conflicts of interest in our relationship with PRCM Advisers LLC, which could result in decisions that are not in the best interests of our stockholders.
Our board of directors approved very broad investment guidelines for PRCM Advisers LLC and does not approve each investment and financing decision made by PRCM Advisers LLC.
We may change any of our strategies, policies or procedures without stockholder consent.
There can be no assurance that the actions of the U.S. government, Federal Reserve, U.S. Treasury and other governmental and regulatory bodies for the purpose of stabilizing the financial markets, including the establishment of the Federal Reserve System s Term Asset-Backed Securities Loan Facility, or TALF, and the U.S. government s Public-Private Investment Program, or PPIP, or market responses to those actions, will achieve the intended effect, and our business may not benefit from these actions and further government actions, or the cessation or curtailment of current U.S. government programs and/or participation in the mortgage and securities markets, or market developments could adversely impact us.
We use leverage in executing our business strategy, which may adversely affect the return on our assets and may reduce cash available for distribution to our stockholders, as well as increase losses when economic or financial conditions are unfavorable.
Our inability to access repurchase agreement or other non-governmental sources of financing would have a material adverse affect on our business.
An increase in our borrowing costs relative to the interest we receive on investments in our target assets may adversely affect our profitability and our cash available for distribution to our stockholders.
Hedging against interest rate exposure may adversely affect our earnings, which could reduce our cash available for paying dividends to our stockholders.
Our investments may be concentrated and will be subject to risk of default. Continued adverse developments in the residential and commercial mortgage markets, including increases in defaults, credit losses and liquidity concerns, could make it difficult for us to borrow money to acquire our target assets on a leveraged basis, on attractive terms or at all, which could adversely affect our profitability.
The mortgage loans underlying the non-Agency RMBS that we acquire are subject to defaults, foreclosure timeline extension, fraud and residential and commercial price depreciation, and unfavorable modification of loan principal amount, interest rate and amortization of principal, which could result in losses to us.
An increase in interest rates may cause a decrease in the volume of certain of our target assets, which could adversely affect our ability to acquire target assets that satisfy our investment objectives and to generate income and pay dividends.
Prepayment rates may adversely affect the value of our investment portfolio.
We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments in our target assets and could also affect the pricing of these target assets.

Our failure to qualify as a REIT would subject us to U.S. federal income tax and potentially increased state and local taxes, which would reduce the amount of cash available for distribution to our stockholders.

Complying with REIT requirements may cause us to forego otherwise attractive investment opportunities or financing or hedging strategies.

Maintenance of our 1940 Act exemption imposes limits on our operations.

Our Structure

The following chart shows our structure subsequent to the completion of the merger with Capitol. We conduct substantially all of our operations through our wholly-owned subsidiary, Two Harbors Operating Company LLC, or the Subsidiary LLC. The Subsidiary LLC in turn conducts its business through two subsidiaries: Two Harbors Asset I, LLC, which holds most of our RMBS and other assets; and Capitol, which we have elected to treat as a TRS, and which holds certain non-RMBS assets and conducts certain hedging activity.

Management Agreement

We have entered into a management agreement with PRCM Advisers LLC, a wholly-owned subsidiary of Pine River. Pursuant to the management agreement, PRCM Advisers LLC implements our business strategy and performs certain services for us, subject to oversight by our board of directors. PRCM Advisers LLC is responsible for, among other duties, (i) performing all of our day-to-day functions, (ii) determining investment criteria in conjunction with our board of directors, (iii) sourcing, analyzing and executing investments, asset sales and financings, and (iv) performing asset management duties.

The initial term of the management agreement expires on October 28, 2012, with automatic one-year renewals at the end of the initial term and each year thereafter. Our independent directors review PRCM Advisers LLC s performance annually and, following the initial term, the management agreement may be terminated annually by us without cause upon the vote of at least two-thirds of our independent directors or by a vote of the holders of a majority of the outstanding shares of our common stock, based upon: (i) PRCM Advisers LLC s unsatisfactory performance that is materially detrimental to us or (ii) our determination that the management fees payable to PRCM Advisers LLC are not fair, subject to PRCM Advisers LLC s right to prevent termination based on unfair fees by accepting a reduction of management fees agreed to by at least two-thirds of our independent directors. We are required to provide PRCM Advisers LLC with 180 days prior notice of such termination. Upon termination without cause, we will pay a termination fee to PRCM Advisers LLC. We will also pay a termination fee to PRCM Advisers LLC if PRCM Advisers LLC terminates the management agreement due to our material breach of such agreement. We may terminate the management agreement with 30 days prior notice from our board of directors, without payment of a termination fee, for cause, as defined in the management agreement. PRCM Advisers LLC may terminate the management agreement if we become required to register as an investment company under the 1940 Act, with such

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termination deemed to occur immediately before such event, and may also decline to renew the management agreement by providing us with 180 days prior notice, in either case of which we would not be required to pay a termination fee.

Base Management Fee

The base management fee paid to PRCM Advisers LLC is 1.5% of our stockholders equity per annum, calculated and payable quarterly in arrears. There is no incentive-based or performance-based component of PRCM Advisers LLC s compensation.

For purposes of calculating the management fee, our stockholders equity means the sum of the net proceeds from all issuances of our equity securities since inception (allocated on a *pro rata* daily basis for such issuances during the fiscal quarter of any such issuance), plus our retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount that we have paid for repurchases of our common stock since inception, and excluding any unrealized gains, losses or other items that do not affect realized net income (regardless of whether such items are included in other comprehensive income or loss, or in net income). This amount will be adjusted to exclude one-time events pursuant to changes in accounting principles generally accepted in the United States of America, or GAAP, and certain non-cash items after discussions between PRCM Advisers LLC and our independent directors and approval by a majority of our independent directors. To the extent asset impairments reduce our retained earnings at the end of any completed calendar quarter it will reduce the base management fee for such quarter. Our stockholders equity for the purposes of calculating the base management fee could be greater than the amount of stockholders equity shown on the consolidated financial statements.

Expense Reimbursement

We reimburse PRCM Advisers LLC for (i) in the event PRCM Advisers LLC were to hire its own personnel, our allocable share of the compensation paid by PRCM Advisers LLC to its personnel serving as our principal financial officer and general counsel and personnel employed by PRCM Advisers LLC as inhouse legal, tax, accounting, consulting, auditing, administrative, information technology, valuation, computer programming and development and back-office resources to us and (ii) any amounts for personnel of PRCM Advisers LLC s affiliates arising under a shared facilities and services agreement.

Termination Fee

Upon termination of the management agreement by us without cause or by PRCM Advisers LLC due to our material breach of the management agreement, we are required to pay a termination fee equal to three times the sum of the average annual base management fee earned by PRCM Advisers LLC during the 24-month period immediately preceding the date of termination, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination.

Conflicts of Interest

We are dependent on PRCM Advisers LLC for our day-to-day management and do not have any independent officers or employees. Each of our executive officers, as well as Brian Taylor and Thomas Siering who are non-independent directors, is also an employee or partner of Pine River, which is the parent company of PRCM Advisers LLC. Our management agreement was negotiated between related parties and its terms, including fees and other amounts payable, may not be as favorable to us as if it had been negotiated at arm s length with an unaffiliated third party. Our executive officers are not required to devote a specific amount of time to our affairs and are permitted to engage in other business activities, including activities for Pine River, which may reduce the time PRCM Advisers LLC and its officers and personnel spend managing us.

We compete for investment opportunities directly with other clients of Pine River and its affiliates. Further, Pine River and its affiliates may in the future form additional funds or sponsor additional investment vehicles and ventures that have objectives overlapping with our objectives and therefore may compete with us for investment opportunities.

In allocating investment opportunities among us and any funds or accounts managed or advised by Pine River, each of which we refer to as a Pine River Fund, Pine River and PRCM Advisers LLC are guided by the principles that they will treat all clients fairly and equitably, they will not arbitrarily distinguish among clients, and they will not favor one client over another. In allocating a specific investment opportunity among us and the Pine River Funds, Pine River and PRCM Advisers LLC will make a determination, exercising their judgment in good faith, as to whether the opportunity is appropriate for each client. Factors in making such a determination may include a client s liquidity, the client s overall investment strategy and objectives, the composition of the client s existing portfolio, the size or amount of the available opportunity, the characteristics of the securities involved, the liquidity of the markets in which the securities trade, the risks involved, and other factors relating to the client and the investment opportunity. Pine River and/or PRCM Advisers LLC are not required to provide every opportunity to every client. If Pine River and/or PRCM Advisers LLC determine that an investment opportunity is appropriate for both us and a Pine River Fund, then Pine River and PRCM Advisers LLC will allocate that opportunity in a manner that they determine, exercising their judgment in good faith, to be fair and equitable, taking into consideration all allocations among us and the Pine River Fund taken as a whole.

Operating and Regulatory Structure

REIT Qualification

We intend to elect to qualify as a REIT under the Code, commencing with our taxable period ended on December 31, 2009. Our qualification as a REIT depends upon our ability to meet on a continuing basis, through actual investment and operating results, various complex requirements under the Code relating to, among other things, the sources of our gross income, the composition and values of our assets, our distribution levels and the diversity of ownership of our shares. We believe that we have been organized in conformity with the requirements for qualification and taxation as a REIT under the Code, and we intend to conduct our operations in a manner which will enable us to meet the requirements for qualification and taxation as a REIT.

As long as we qualify as a REIT, we generally will not be subject to U.S. federal income tax on the REIT taxable income we distribute currently to our stockholders. If we fail to qualify as a REIT in any taxable year and do not qualify for certain statutory relief provisions, we will be subject to U.S. federal income tax at regular corporate rates and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year during which we lost our REIT qualification. Even if we qualify for taxation as a REIT, we may be subject to certain U.S. federal, state and local taxes on our income or property.

1940 Act Exemption

We intend to conduct our operations so that we are not required to register as an investment company under the 1940 Act. The 1940 Act exempts entities that are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate, or qualifying interests. Under the current interpretation of the staff of the U.S. Securities and Exchange Commission, or SEC, in order to qualify for this exemption, we must maintain (i) at least 55% of our assets in qualifying interests (referred to as the 55% Test) and (ii) at least 80% of our assets in real estate related assets including qualifying interests (referred to as the 80% Test). In meeting the 55% Test, we treat as qualifying interests those RMBS issued with respect to an underlying pool as to which we own all of the issued certificates. RMBS that do not represent all of the certificates issued (i.e., an undivided interest) with respect to the entire pool of mortgages (i.e., a whole pool) underlying such RMBS may be treated as securities separate from such underlying mortgage loans and, thus, may not be considered qualifying interests for purposes of the 55% Test; however, such RMBS would be considered real estate related assets for purposes of the 80% Test. Therefore, for purposes of the 55% Test, our ownership of these types of RMBS is limited by the provisions of the 1940 Act. If the SEC or its staff were to adopt a contrary interpretation, we could be required to sell a substantial amount of our RMBS under potentially adverse market conditions. Further, in order to ensure that at all times we qualify for this exemption from the 1940 Act, we may be precluded from acquiring RMBS with a yield higher than the yield on RMBS that could be otherwise purchased in a manner consistent with this exemption. Accordingly, we monitor our compliance with both the 55% Test and the 80% Test in order to maintain our exempt status under the 1940 Act.

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Restrictions on Ownership of Our Common Stock

To assist us in complying with the REIT limitations on the concentration of ownership imposed by the Code, among other purposes, our charter prohibits, with certain exceptions, any stockholder from beneficially or constructively owning, applying certain attribution rules under the Code, more than 9.8% by value or number of shares, whichever is more restrictive, of our outstanding shares of common stock, or 9.8% by value or number of shares, whichever is more restrictive, of our outstanding capital stock. Our board of directors may, in its sole discretion, waive the 9.8% ownership limit with respect to a particular stockholder if it is presented with certain representations and undertakings required by our charter and other evidence satisfactory to it that such ownership will not then or in the future jeopardize our qualification as a REIT. Our charter also prohibits any person from, among other things: (1) beneficially or constructively owning shares of our capital stock that would result in our being closely held under Section 856(h) of the Code, or otherwise cause us to fail to qualify as a REIT; and (2) transferring shares of our capital stock if such transfer would result in our capital stock being beneficially owned by fewer than 100 persons.

Our Corporate Information

Our headquarters are located at 601 Carlson Parkway, Suite 330, Minnetonka, Minnesota 55305 and our telephone number is (612) 238-3300. We maintain a website at *www.twoharborsinvestment.com*; however, the information found on this website is not a part of this prospectus.

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Summary Selected Financial and Other Data

Balance Sheet Data:	At December 31, 2009[(1)]	2008[(1)]
Available-for-sale securities	$494,464,867	
Total assets	538,365,409	262,095,130
Repurchase agreements	411,892,510	
Total stockholders equity	121,720,767	184,161,891

Income Statement Data:	At or for the Year Ended December 31, 2009[(1)]	2008[(1)]	At or for the Period from June 26, 2007 (inception) through December 31, 2007[(1)]
Interest income	$2,866,053	$4,442,222	$1,474,220
Interest expense	131,510		
Net interest income	2,734,543	4,442,222	1,474,220
Other income	699,632		
Management fees	325,654		
Operating expenses	12,171,343	1,059,606	140,999
Net (loss) income before income taxes	(9,062,822)	3,382,616	1,333,221
Benefit from (provision for) income taxes	318,291	(1,088,083)	(618,648)
Net (loss) income	$(8,744,531)	$2,294,533	$714,573
Accretion of Trust Account income relating to common stock subject to possible conversion	(92,872)	(235,706)	
Net (loss) income attributable to other common stockholders	$(8,837,403)	$2,058,827	$714,573
Basic and diluted (loss) earnings per share	$(0.39)	$0.08	$0.06
Dividends declared per common share	$0.26	$	$
Basic and diluted weighted average shares outstanding	22,941,728	24,936,558	11,602,789

(1) Capitol, the accounting acquirer in the merger completed on October 28, 2009, was formed on June 26, 2007 as a development stage company. As such, our results of operations are presented for only the periods set forth above. Comparability of the financial data is affected by the merger with Capitol.

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Core Earnings and Adjusted Core Earnings:	For the Year Ended December 31, 2009(2)
Reconciliation of net (loss) income attributable to other common stockholders to adjusted core earnings:	
Net (loss) income attributable to other common stockholders	$(8,837,403)
Adjustments for non-core earnings:	
Gain on sales of securities, net	(335,966)
Unrealized gain on interest rate swap agreements	(363,666)
Eliminate tax charge for unrealized gain on interest rate swap agreements	123,646
Core earnings	$(9,413,389)
Adjustments for non-recurring expenses:	
Costs associated with business combination	9,572,218
Costs associated with Capitol (pre-merger)	1,346,747
Eliminate tax benefits driven by costs associated with Capitol	(441,937)
Adjusted core earnings	$1,063,639
Shares outstanding at period end	13,379,209
Adjusted core earnings per share outstanding	NM

NM = not meaningful

(2) Capitol, the accounting acquirer in the merger completed on October 28, 2009 was formed on June 26, 2007 as a development stage company. As such, the results of operations for the year ended December 31, 2009 represent Capitol s results until the consummation of the merger and our results for the remainder of the year. In addition, comparability of our results of operations for the year ended December 31, 2009 to prior is affected by the merger with Capitol.

Core Earnings and Adjusted Core Earnings represent non-GAAP financial measures that are calculated as shown in the table above. Management uses Core Earnings and Adjusted Core Earnings to evaluate results of the business. We believe that analyzing the trends of the underlying business is aided by use of Core Earnings due to the significant impact this measure has on comparability from period to period. We believe that analyzing the trends of the underlying business is aided by use of Adjusted Core Earnings because costs associated with the business combination with the merger with Capitol are not expected to be incurred in the future.

The non-GAAP financial measures disclosed by us should not be considered a substitute for, or superior to, financial measures calculated in accordance with GAAP, and the financial results calculated in accordance with GAAP and reconciliations from these results should be carefully evaluated.

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THE OFFERING

Common stock offered by us
14,000,000 shares (plus up to an additional 2,100,000 shares of our common stock that we may issue and sell upon the exercise of the underwriters over-allotment option).

Common stock to be outstanding after this offering
27,379,209 shares.(1)

Use of Proceeds
We plan to use all of the net proceeds from this offering as described above to acquire our target assets in accordance with our objectives and strategies described in this prospectus. See *Use of Proceeds*. Our focus will be on purchasing Agency RMBS, non-Agency RMBS, and certain non-real estate investments including certain hedging transactions that may produce non-qualifying income for purposes of the REIT gross income tests. Prior to the time we have fully used the net proceeds of this offering to acquire our target assets, we may fund our quarterly distributions out of such net proceeds.

Dividend Policy
We intend to continue to make regular quarterly distributions to holders of our common stock consistent with maintaining our REIT qualification for U.S. federal income tax law purposes. On December 21, 2009, we declared a dividend of $0.26 per share of common stock to stockholders of record as of December 31, 2009 and paid such dividend on January 26, 2010. On March 12, 2010, we declared a dividend of $0.36 per share of common stock to stockholders of record as of March 31, 2010, and we intend to pay such dividend on April 23, 2010. Investors in this offering will not be entitled to receive this dividend. For more information, see *Dividend Policy*.

Listing
Our common stock is listed on the NYSE Amex under the symbol TWO .

Transfer Restrictions
To assist us in qualifying as a REIT, ownership of shares of our common stock by any person is limited, with certain exceptions, to 9.8% by value or by number of shares, whichever is more restrictive, of our outstanding shares of common stock and 9.8% by value or by number of shares, whichever is more restrictive, of our outstanding capital stock.

Record Date for Annual Meeting
The record date to vote on matters considered at our annual meeting of stockholders to be held on June 14, 2010, is April 19, 2010. As a result purchasers of shares in this offering will not be entitled to vote on such matters.

Risk Factors
Investing in our common stock involves a high degree of risk. You should carefully read and consider the information set forth under the heading *Risk Factors* beginning on page 16 of this prospectus and all other information in this prospectus before investing in our common stock.

(1) Excludes 2,100,000 shares of our common stock that we may issue and sell upon exercise of the underwriters over allotment option in full.

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RISK FACTORS

The following is a summary of the risk factors that we believe are most relevant to our business. These are factors which, individually or in the aggregate, we think could cause our actual results to differ significantly from anticipated or historical results. In addition to understanding the key risks described below, investors should understand that it is not possible to predict or identify all risk factors, and consequently, the following is not a complete discussion of all potential risks or uncertainties.

Risks Related to Our Business and Operations

The value of your investment is subject to the significant risks affecting REITs, and mortgage REITs in particular, described below. If any of the events described below occur, our business, financial condition, liquidity and/or results of operations could be adversely affected in a material way. This could cause the price of our common stock to decline, perhaps significantly, and you therefore may lose all or part of your investment.

We operate in a highly competitive market and competition may limit our ability to acquire desirable assets.

We operate in a highly competitive market. Our profitability depends, in large part, on our ability to acquire target assets at favorable prices. In acquiring assets, we compete with a variety of institutional investors, including other REITs, specialty finance companies, public and private funds, commercial and investment banks, commercial finance and insurance companies, governmental entities and other financial institutions. Many of our competitors are substantially larger and have greater financial, technical, marketing and other resources than we do. Furthermore, competition for assets may lead to the price of such assets increasing and their availability decreasing, which may limit our ability to generate desired returns.

The RMBS investment strategy that PRCM Advisers LLC s owner, Pine River, employs on behalf of other clients is different from the investment strategy that we employ.

PRCM Advisers LLC draws upon the experience of Pine River s fixed income investment team in implementing our investment and financing strategies. However, the investment strategy that Pine River has employed in connection with other RMBS investments is different from the investment strategy that we employ in several important respects. In particular, Pine River has typically traded actively in fixed-rate, adjustable and interest-only RMBS, including collateralized mortgage obligations and to-be-announced forward contracts, or TBAs, and equity investments in REITs, and actively hedged its trading positions. By contrast, we seek to invest primarily in Agency and non-Agency RMBS with a buy-and-hold emphasis, and we do not anticipate actively trading our assets. Our investment strategy may further differ from that of Pine River s funds, in that we may use greater leverage with regard to our investments in Agency RMBS. Further, unlike the Pine River funds, we are constrained by limitations on our investment strategy that are necessary in order to qualify as a REIT that is exempt from registration under the 1940 Act. In this regard, we place a greater emphasis than Pine River on owning securities representing 100% of the interests in a particular RMBS mortgage pool, or whole pool Agency RMBS, for purposes of maintaining our 1940 Act exemption.

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

We may change any of our strategies, policies or procedures with respect to investments, asset allocation, growth, operations, indebtedness, financing strategy and distributions at any time without the consent of stockholders, which could result in our making investments that are different from, and possibly riskier than, the types of investments described in this prospectus. A change in strategy may increase our exposure to credit risk, interest rate risk, financing risk, default risk and real estate market fluctuations. These changes could adversely affect our financial condition, risk profile, results of operations, the market price of our common stock and our ability to make distributions to stockholders.

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Difficult conditions in the mortgage and residential real estate markets, the financial markets and the economy generally may cause the market value of our RMBS assets to decline, and we do not expect these conditions to improve in the near future.

Our results of operations are materially affected by conditions in the mortgage and residential real estate markets, the financial markets and the economy generally. Recently, concerns about the mortgage market and a declining real estate market, as well as inflation, energy costs, geopolitical issues and the availability and cost of credit, have contributed to increased volatility and diminished expectations for the economy and financial markets going forward. The mortgage market has been adversely affected by the tightening of lending standards and general availability of credit and there is no assurance that these conditions have stabilized or that they will not worsen. This has an impact on new demand for homes, which will compress the home ownership rates and weigh heavily on future home price performance. There is a strong correlation between home price growth rates (or losses) and mortgage loan delinquencies. The further deterioration of the mortgage market may cause us to experience losses related to our assets. Declines in the market values of our investments may adversely affect our results of operations and credit availability, which may reduce earnings and, in turn, cash available for distribution to stockholders.

There can be no assurance that the actions of the U.S. Government, Federal Reserve, U.S. Treasury and other governmental and regulatory bodies for the purpose of stabilizing the financial markets, or market response to those actions, will achieve the intended results; our business may not benefit from these actions and further government or market developments could adversely impact us.

In response to turmoil in the financial markets beginning in 2007, the U.S. Government, Federal Reserve, U.S. Treasury and other governmental and regulatory bodies have taken action to stabilize the financial markets. Significant measures include: the enactment of the Emergency Economic Stabilization Act of 2008 which, among other things, established the Troubled Asset Relief Program, or TARP, to purchase certain assets from financial institutions; the enactment of the Housing and Economic Recovery Act of 2008, which established a new regulator for Fannie Mae and Freddie Mac; the establishment of the TALF, which provides non-recourse loans to borrowers to fund their purchase of eligible assets, which currently include certain asset-backed securities and commercial mortgage-backed securities; the establishment of the Public-Private Investment Program, which is designed to encourage the transfer of certain legacy assets, including real estate-related assets, off of the balance sheets of financial institutions; and the implementation of the Home Affordable Modification program, to facilitate the modification of delinquent mortgages and reduce foreclosures.

There can be no assurance that these recent U.S. Government actions will improve the efficiency and stability of the financial markets, and the residential mortgage markets in particular, in the long term. To the extent the financial markets do not respond favorably to these initiatives or these initiatives do not function as intended, our business may be harmed. There also can be no assurance that we will be eligible to participate in programs established by the U.S. Government or, if we are eligible, that we will be able to utilize them successfully or at all. In addition, because the programs are designed, in part, to improve the markets for certain of our target assets, the establishment of these programs may result in increased competition for attractive opportunities in our target assets. The U.S. Government, Federal Reserve, U.S. Treasury and other governmental and regulatory bodies have taken or are considering taking additional actions to address the financial crisis. We cannot predict whether or when such actions may occur, and such actions could have an adverse impact on our business, results of operations and financial condition.

The lack of liquidity of our assets may adversely affect our business, including our ability to value and sell our assets.

We may acquire assets or other instruments that are not liquid, including securities and other instruments that are not publicly traded, and market conditions could significantly and negatively impact the liquidity of other assets. It may be difficult or impossible to obtain third-party pricing on the assets that we purchase. Illiquid assets typically experience greater price volatility, as a ready market may not exist for such assets, and such assets can be more difficult to value. In addition, validating third-party pricing for illiquid assets may be more subjective than more liquid assets. Any illiquidity of our assets may make it difficult for us to sell such assets if the need or desire arises. In addition, if we are required to liquidate all or a portion of our portfolio

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quickly, we may realize significantly less than the value at which we previously recorded our assets. Assets that are illiquid are more difficult to finance, and to the extent that we use leverage to finance assets that become illiquid we may lose that leverage or have it reduced. Assets tend to become less liquid during times of financial stress, which is often the time that liquidity is most needed. As a result, our ability to sell assets or vary our portfolio in response to changes in economic and other conditions may be limited by liquidity constraints, which could adversely affect our results of operations and financial condition.

Maintenance of our 1940 Act exemption imposes limits on our operations.

We intend to conduct our operations so as not to become required to register as an investment company under the 1940 Act. Section 3(a)(1)(A) of the 1940 Act defines an investment company as any issuer that is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities. Section 3(a)(1)(C) of the 1940 Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer s total assets (exclusive of U.S. Government securities and cash items) on an unconsolidated basis. Excluded from the term investment securities, among other things, are U.S. Government securities and securities issued by majority-owned subsidiaries that are not themselves investment companies and are not relying on the exception from the definition of investment company set forth in Section 3(c)(1) or Section 3(c)(7) of the 1940 Act.

We are organized as a holding company that conducts its businesses primarily through Subsidiary LLC. Both we and Subsidiary LLC intend to conduct our operations so that we do not come within the definition of an investment company because less than 40% of the value of our total assets on an unconsolidated basis will consist of investment securities.

Certain of Subsidiary LLC s subsidiaries intend to rely upon the exemption from registration as an investment company under the 1940 Act pursuant to Section 3(c)(5)(C) of the 1940 Act, which is available for entities primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. This exemption generally means that at least 55% of each such subsidiary s portfolio must be comprised of qualifying assets and at least 80% of its portfolio must be comprised of qualifying assets and real estate-related assets under the 1940 Act. Qualifying assets for this purpose include mortgage loans and other assets, such as whole pool Agency and non-Agency RMBS, which are considered the functional equivalent of mortgage loans for the purposes of the 1940 Act. We expect each of our subsidiaries relying on Section 3(c)(5)(C) to invest at least 55% of its assets in whole pool Agency and non-Agency RMBS and other interests in real estate that constitute qualifying assets in accordance with SEC staff guidance and an additional 25% of its assets in either qualifying assets and other types of real estate related assets that do not constitute qualifying assets.

As a result of the foregoing restrictions, we are limited in our ability to make or dispose of certain investments. To the extent that the SEC staff publishes new or different guidance with respect to these matters, we may be required to adjust our strategy accordingly. In addition, we may be limited in our ability to make certain investments and these limitations could result in the subsidiary holding assets that we might wish to sell or selling assets that we might wish to hold. Although we monitor the portfolios of our subsidiaries relying on the Section 3(c)(5)(C) exemption periodically and prior to each acquisition or disposition of assets, there can be no assurance that such subsidiaries will be able to maintain this exemption.

We may organize special purpose subsidiaries that will borrow under the TALF. We expect that these TALF subsidiaries will rely on Section 3(c)(7) for their 1940 Act exemption and, therefore, our interest in each of these TALF subsidiaries would constitute an investment security for purposes of determining whether we pass the 40% test.

We may organize one or more TALF subsidiaries, as well as other subsidiaries, that seek to rely on the 1940 Act exemption provided to certain structured financing vehicles by Rule 3a-7. To the extent that we organize subsidiaries that rely on Rule 3a-7 for an exemption from the 1940 Act, these subsidiaries will also need to comply with the provisions of Rule 3a-7, which in certain circumstances may require, among other things, that the indenture governing the notes issued by the subsidiary include additional limitations on the types of assets the subsidiary may sell or acquire out of the proceeds of assets that mature, are refinanced or otherwise sold, on the period of time during which such transactions may occur, and on the

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amount of transactions that may occur. In addition, any subsidiaries organized to rely on Rule 3a-7 will also need to comply with guidance that may be issued by the Division of Investment Management of the SEC on how such subsidiaries must be organized to comply with the restrictions contained in Rule 3a-7. In light of the requirements of Rule 3a-7, our ability to manage assets held in a special purpose subsidiary that complies with Rule 3a-7 will be limited and we may not be able to purchase or sell assets owned by that subsidiary when we would otherwise desire to do so, which could lead to losses. We expect that the aggregate value of our interests in TALF subsidiaries that seek to rely on Rule 3a-7, as well as other subsidiaries that we may organize in the future that may rely on Rule 3a-7, will comprise less than 20% of our total assets on an unconsolidated basis.

We will make the determination of whether an entity is a majority-owned subsidiary. The 1940 Act defines a majority-owned subsidiary of a person as a company 50% or more of the outstanding voting securities of which are owned by such person, or by another company which is a majority-owned subsidiary of such person. The 1940 Act further defines voting securities as any security presently entitling the owner or holder thereof to vote for the election of directors of a company. We treat companies in which we own at least a majority of the outstanding voting securities as majority-owned subsidiaries for purposes of the 40% test. We have not requested the SEC staff to approve our treatment of any company as a majority-owned subsidiary and the SEC staff has not done so. If the SEC or its staff were to disagree with our treatment of one or more companies as majority-owned subsidiaries, we would need to adjust our strategy and our assets in order to continue to pass the 40% test. Any such adjustment in our strategy could have a material adverse effect.

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

Loss of our 1940 Act exemption would adversely affect us, the market price of shares of our common stock and our ability to distribute dividends, and could result in the termination of the management agreement with PRCM Advisers LLC.

As described above, we intend to conduct operations so as not to become required to register as an investment company under the 1940 Act based on current laws, regulations and guidance. Although we monitor our portfolio periodically, there can be no assurance that we will be able to maintain our exemption from registration as an investment company under the 1940 Act. If we were to fail to qualify for an exemption, we could be required to restructure our activities or the activities of our subsidiaries, including effecting sales of assets in a manner that, or at a time when, we would not otherwise choose, which could negatively affect the value of our common stock, the sustainability of our business model, and our ability to make distributions. Such sales could occur during adverse market conditions, and we could be forced to accept prices below that which we believe are appropriate. The loss of our 1940 Act exemption would also permit PRCM Advisers LLC to terminate the management agreement, which could result in a material adverse effect on our business and results of operations.

Rapid changes in the values of our assets may make it more difficult for us to maintain our qualification as a REIT or our exemption from the 1940 Act.

If the market value or income potential of our assets declines as a result of increased interest rates, prepayment rates, general market conditions, government actions or other factors, we may need to increase our real estate assets and income or liquidate our non-qualifying assets to maintain our REIT qualification or our exemption from the 1940 Act. If the decline in real estate asset values or income occurs quickly, this may be especially difficult to accomplish. This difficulty may be exacerbated by the illiquid nature of any non-real estate assets we may own. We may have to make decisions that we otherwise would not make absent the REIT and 1940 Act considerations.

We use leverage in executing our business strategy, which may adversely affect the return on our assets and may reduce cash available for distribution to our stockholders, as well as increase losses when economic conditions are unfavorable.

We use leverage to finance our investment operations and to enhance our financial returns. Our primary source of leverage is repurchase agreement financing for our Agency RMBS assets. Other sources of leverage may include credit facilities (including term loans and revolving facilities).

Through the use of leverage, we may acquire positions with market exposure significantly greater than the amount of capital committed to the transaction. For example, by entering into repurchase agreements with advance rates, or haircut levels, of 5% (which is not an atypical haircut for Agency RMBS), we could leverage capital allocated to Agency RMBS by a ratio of as much as 20 to 1. It is not uncommon for investors in Agency RMBS to obtain leverage equal to ten or more times equity through the use of repurchase agreement financing. We anticipate that we may deploy, on a debt-to-equity basis, up to ten times leverage on our Agency RMBS assets and up to two times leverage on our non-Agency RMBS assets. However, there is no specific limit on the amount of leverage that we may use.

Leverage will magnify both the gains and the losses of our positions. Leverage will increase our returns as long as we earn a greater return on investments purchased with borrowed funds than our cost of borrowing such funds. However, if we use leverage to acquire an asset and the value of the asset decreases, the leverage will increase our losses. Even if the asset increases in value, if the asset fails to earn a return that equals or exceeds our cost of borrowing, the leverage will decrease our returns.

We may be required to post large amounts of cash as collateral or margin to secure our leveraged positions. In the event of a sudden, precipitous drop in the value of our financed assets, we might not be able to liquidate assets quickly enough to repay our borrowings, further magnifying losses. Even a small decrease in the value of a leveraged asset may require us to post additional margin or cash collateral. This may decrease the cash available to us for distributions to stockholders.

We depend on repurchase agreements and other credit facilities to execute our business plan and our inability to access funding through these sources could have a material adverse effect on our results of operations, financial condition and business.

Our ability to purchase and hold assets is affected by our ability to secure repurchase agreements and other credit facilities on acceptable terms. We currently have master repurchase agreements in place with several counterparties and we expect to execute additional master repurchase agreements, but we can provide no assurance that lenders will be willing or able to provide us with sufficient financing through the repurchase markets or otherwise. In addition, because repurchase agreements are short-term commitments of capital, changes in conditions in the repurchase markets may make it more difficult for us to secure continued financing. During certain periods of a credit cycle, lenders may lose their ability or curtail their willingness to provide financing. If we are not able to arrange for replacement financing on acceptable terms, or if we default on our covenants or are otherwise unable to access funds under any of our master repurchase agreements, we may have to curtail our asset acquisition activities and/or dispose of assets.

It is possible that the lenders that provide us with financing could experience changes in their ability to advance funds to us, independent of our performance or the value of our assets. If major market participants exit the business, it could further adversely affect the marketability of RMBS and other financial assets in which we invest, and this could negatively impact the value of our assets, thus reducing our net book value. Furthermore, if many of our lenders are unwilling or unable to provide us with financing, we could be forced to sell assets when prices are depressed. In addition, if the regulatory capital requirements imposed on our lenders change, they may be required to significantly increase the cost of the financing that they provide to us. Our lenders also may revise their eligibility requirements for the types of assets they are willing to finance or the terms of such financings, based on, among other factors, the regulatory environment and their management of perceived risk. Moreover, the amount of financing we receive under our repurchase agreements will be directly related to the lenders valuation of the assets that secure the outstanding borrowings. Typically, repurchase agreements grant the respective lender the right to reevaluate the market value of the assets that secure outstanding borrowings at any time. If a lender determines that the value of the assets has decreased, it

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has the right to initiate a margin call. A margin call would require us to transfer additional assets to such lender or to repay a portion of the outstanding borrowings. Any such margin call could have a material adverse effect on our results of operations, financial condition, business, liquidity and ability to make distributions to stockholders, and could cause the value of our common stock to decline. We may be forced to sell assets at significantly depressed prices to meet margin calls and to maintain adequate liquidity, which could cause us to incur losses. Moreover, to the extent that we are forced to sell assets because of changes in market conditions, other market participants may face similar pressures, which could exacerbate a difficult market environment and which could result in significantly greater losses on our sale of such assets. In an extreme case of market duress, a market may not exist for certain of our assets at any price.

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

When we enter into repurchase agreements, we sell securities to lenders (i.e., repurchase agreement counterparties) and receive cash from the lenders. The lenders are obligated to resell the same securities back to us at the end of the term of the repurchase agreement. Because the cash that we receive from the lender when we initially sell the securities to the lender is less than the value of those securities (the difference being the haircut), if the lender defaults on its obligation to resell the same securities back to us, we would incur a loss on the repurchase agreement equal to the amount of the haircut (assuming there was no change in the value of the securities). We would also incur losses on a repurchase agreement if the value of the underlying securities has declined as of the end of the repurchase agreement term, because we would have to repurchase the securities for their initial value but would receive securities worth less than that amount. Further, if we default on our obligations under a repurchase agreement, the lender will be able to terminate the repurchase agreement and cease entering into any other repurchase agreements with us. Typically, our repurchase agreements contain cross-default provisions, so that if a default occurs under any repurchase agreement, the lender can also declare a default with respect to all other repurchase agreements with us. If a default occurs under any of our repurchase agreements and a lender terminates one or more of its repurchase agreements, we may need to enter into replacement repurchase agreements with different lenders. There can be no assurance that we will be successful in entering into such replacement repurchase agreements on the same terms as the repurchase agreements that were terminated or at all. Any losses that we incur on our repurchase agreements could adversely affect our earnings and thus our cash available for distribution to stockholders.

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

As our repurchase agreements and other short-term borrowings mature, we must enter into new borrowings, find other sources of liquidity or sell assets. An increase in short-term interest rates at the time that we seek to enter into new borrowings would reduce the spread between the returns on our assets and the cost of our borrowings. This would adversely affect the returns on our assets, which might reduce earnings and, in turn, cash available for distribution to stockholders.

Our business model depends in part upon the continuing viability of Fannie Mae and Freddie Mac, or similar institutions, and any significant changes to their structure or creditworthiness could have an adverse impact on us.

In the wake of the financial turmoil that began in 2007, Fannie Mae and Freddie Mac have become the dominant, and in some cases the only, source of mortgage financing in the U.S. The continued flow of mortgage-backed securities from these government-sponsored entities, or GSEs, supported by their guarantees against borrower defaults, is essential to the operation of the mortgage markets in their current form, and crucial to our business model. The U.S Congress has announced an intention to consider the elimination or restructuring of these GSEs, and there can be no assurance of the continuation of Fannie Mae and Freddie Mac as currently constituted and operated. Any significant changes to the structure of these GSEs could have an adverse impact on us. In December 2009, the U.S. Government committed virtually unlimited capital to ensure the viability of Fannie Mae and Freddie Mac into 2012, however there can be no assurance that such capital will always be available, or that these GSEs will always honor their guarantees and other obligations.

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If these GSEs fail to honor their guarantees, the value of any Agency RMBS assets that we hold would decline, which would materially adversely affect our business, operations and financial condition.

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

Our business is highly dependent on communications and information systems of PRCM Advisers LLC and Pine River. Any failure or interruption of the systems of PRCM Advisers LLC or Pine River could cause delays or other problems in our trading activities, which could have a material adverse effect on our financial results and negatively affect the market price of our common stock and our ability to pay dividends to stockholders.

We enter into hedging transactions that expose us to contingent liabilities in the future, which may adversely affect our financial results or cash available for distribution to stockholders.

We engage in hedging transactions intended to hedge various risks to our portfolio, including the exposure to adverse changes in interest rates. Our hedging activity varies in scope based on, among other things, the level and volatility of interest rates, the type of assets held and other changing market conditions. Although these transactions are intended to reduce our exposure to various risks, hedging may fail to protect or could adversely affect us because, among other things:

- hedging can be expensive, particularly during periods of volatile or rapidly changing interest rates;
- available hedges may not correspond directly with the risks for which protection is sought;
- the duration of the hedge may not match the duration of the related liability;
- the amount of income that a REIT may earn from certain hedging transactions (other than through TRSs) is limited by U.S. federal income tax provisions governing REITs;
- the credit quality of a hedging counterparty may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the hedging counterparty may default on its obligation to pay.

Subject to maintaining our qualification as a REIT, there is no limitation on the hedging transactions that we may undertake. Our hedging transactions could require us to fund large cash payments in certain circumstances (*e.g.*, the early termination of the hedging instrument caused by an event of default or other early termination event, or a demand by a counterparty that we make increased margin payments). Our ability to fund these obligations will depend on the liquidity of our assets and access to capital at the time. The need to fund these obligations could adversely impact our financial condition. Further, hedging transactions, which are intended to limit losses, may actually result in losses, which would adversely affect our earnings and could in turn reduce cash available for distribution to stockholders.

Hedging instruments involve risk because they often are not traded on regulated exchanges, guaranteed by an exchange or its clearinghouse, or regulated by any U.S. or foreign governmental authorities. Consequently, there may be no requirements with respect to record keeping, financial responsibility or segregation of customer funds and positions. Furthermore, the enforceability of agreements underlying hedging transactions may depend on compliance with applicable statutory and commodity and other regulatory requirements and, depending on the identity of the counterparty, applicable international requirements. The business failure of a hedging counterparty will most likely result in its default. Default by a hedging counterparty may result in the loss of unrealized profits and force us to cover our commitments, if any, at the then current market price. Although generally we seek to reserve the right to terminate our hedging positions, it may not always be possible to dispose of or close out a hedging position without the consent of the hedging counterparty and we may not be able to enter into an offsetting contract in order to cover our risk. We cannot assure you that a liquid secondary market will exist for hedging instruments purchased or sold, and we may be required to maintain a position until exercise or expiration, which could result in losses.

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Our results may experience greater fluctuations because we have not elected hedge accounting treatment on the derivatives that we enter into.

We have elected to not qualify for hedge accounting treatment under Accounting Standards Codification, or ASC 815, *Derivatives and Hedging,* for our current derivative instruments. The economics of our derivative hedging transactions are not affected by this election; however, our GAAP earnings may be subject to greater fluctuations from period to period as a result of this accounting treatment for changes in fair value of certain interest rate swap agreements or for the accounting of the underlying hedged assets or liabilities in our financial statements, if it does not necessarily match the accounting used for interest rate swap agreements.

We have limited experience in making critical accounting estimates, and our financial statements may be materially affected if our estimates prove to be inaccurate.

Financial statements prepared in accordance with GAAP require the use of estimates, judgments and assumptions that affect the reported amounts. Different estimates, judgments and assumptions reasonably could be used that would have a material effect on the financial statements, and changes in these estimates, judgments and assumptions are likely to occur from time to time. Significant areas of accounting requiring the application of management s judgment include assessing the adequacy of the allowance for loan losses and determining the fair value of investment securities. These estimates, judgments and assumptions are inherently uncertain, and, if they prove to be wrong, then we face the risk that charges to income will be required. In addition, because we have limited operating history in some of these areas and limited experience in making these estimates, judgments and assumptions, the risk of future charges to income may be greater than if we had more experience in these areas. Any such charges could significantly harm our business, financial condition, results of operations and the price of our securities. See *Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies* for a discussion of the accounting estimates, judgments and assumptions that we believe are the most critical to an understanding of our business, financial condition and results of operations.

Declines in the market values of our assets may adversely affect our periodic reported results and credit availability, which may reduce earnings and, in turn, cash available for distribution to stockholders.

A substantial portion of our assets are classified for accounting purposes as available-for-sale, or AFS. Changes in the market values of those assets will be directly charged or credited to stockholders equity. As a result, a decline in values may reduce our book value. Moreover, if the decline in value of an AFS security is other than temporary, such decline will reduce earnings.

A decline in the market value of our assets may adversely affect us, particularly in instances where we have borrowed money based on the market value of those assets. If the market value of those assets declines, the lender may require us to post additional collateral to support the loan. If we are unable to post the additional collateral, we would have to sell the assets at a time when we might not otherwise choose to do so. A reduction in credit available may reduce our earnings and, in turn, cash available for distribution to stockholders.

Changes in accounting treatment may adversely affect our profitability.

In February 2008, the Financial Accounting Standards Board, or FASB, issued final guidance regarding the accounting and financial statement presentation for transactions that involve the acquisition of RMBS, residential mortgage loans and other financial assets from a counterparty and the subsequent financing of these securities through repurchase agreements with the same counterparty. If we do not meet the criteria under the final guidance to account for the transactions on a gross basis, the accounting treatment would not affect the economics of these transactions, but would affect how these transactions are reported on our financial statements. If we are not able to comply with the criteria under this final guidance for same party transactions, we would be precluded from presenting RMBS, residential mortgage loans and other financial assets and the related financings, as well as the related interest income and interest expense, on a gross basis on our financial statements. Instead, we would be required to account for the purchase commitment and related repurchase agreement on a net basis and record a forward commitment to purchase RMBS, residential mortgage loans and other financial assets as a derivative instrument. Such forward commitments would be recorded at fair value with subsequent changes in fair value recognized in earnings. Additionally, we would record the cash

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portion of our interest in RMBS, residential mortgage loans and other financial assets as a mortgage-related receivable from the counterparty on our balance sheet. Although we would not expect this change in presentation to have a material impact on net income, it could have an adverse impact on our operations. It could have an impact on our ability to include certain RMBS, residential mortgage loans and other financial assets purchased and simultaneously financed from the same counterparty as qualifying real estate interests or real estate-related assets used to qualify under the exemption from registration as an investment company under the 1940 Act. It could also limit our opportunities as we may need to limit our purchases of RMBS, residential mortgage loans and other financial assets that are simultaneously financed with the same counterparty.

Risks Related to our Management and Relationship with PRCM Advisers LLC and Pine River

We are dependent on PRCM Advisers LLC and Pine River and may not find a suitable replacement if we or PRCM Advisers LLC terminate the management agreement.

We have no employees and no separate facilities. Instead, we are completely reliant for these resources on PRCM Advisers LLC, which has significant discretion as to the implementation and execution of our business strategies and risk management practices. PRCM Advisers LLC may not have sufficient access to Pine River s employees, systems and facilities in order to comply with its obligations under the management agreement. We are also subject to the risk that PRCM Advisers LLC will terminate the management agreement and that no suitable replacement will be found.

PRCM Advisers LLC is only contractually committed to serve us until October 28, 2012. Thereafter, the management agreement is renewable on an annual basis; provided, however, that PRCM Advisers LLC may terminate the management agreement annually upon 180 days prior notice. If the management agreement is terminated and no suitable replacement is found to manage our business, we may not be able to execute our business plan.

We will have no recourse to Pine River if it does not fulfill its obligations under the shared facilities and services agreement.

Neither we nor PRCM Advisers LLC has any employees or separate facilities. As a result, PRCM Advisers LLC has entered into a shared facilities and services agreement with Pine River pursuant to which PRCM Advisers LLC will be provided with the personnel, services and resources necessary for PRCM Advisers LLC to perform its obligations and responsibilities under the management agreement in exchange for certain amounts payable by PRCM Advisers LLC. Because we are not a party to the shared facilities and services agreement, we will not have any recourse to Pine River if it does not fulfill its obligations under the shared facilities and services agreement, or if Pine River and PRCM Advisers choose to amend or terminate the shared facilities and services agreement.

There are conflicts of interest in our relationship with Pine River and its affiliates, including PRCM Advisers LLC, which could result in decisions that are not in the best interests of our stockholders.

We are subject to conflicts of interest arising out of our relationship with Pine River and its affiliates, including PRCM Advisers LLC. PRCM Advisers LLC is wholly-owned by Pine River. Each of Brian Taylor (the Chairman of our board of directors), Thomas Siering (a director, and our Chief Executive Officer and President), Steven Kuhn (our Co-Chief Investment Officer), Jeff Stolt (our Chief Financial Officer) and Timothy O Brien (our General Counsel) is a partner and owner of equity interests in Pine River. All of our other executive officers are employees or partners of Pine River. In addition, Mark Ein (the non-executive Vice Chairman) owns an interest in CLA Founders LLC, which, in consideration for services to be provided to PRCM Advisers LLC under a sub-management agreement, is entitled to receive a percentage of the management fee earned by PRCM Advisers LLC, and an affiliate of his is an investor in a private fund for which Pine River serves as investment manager. As a result, the management agreement with PRCM Advisers LLC was negotiated between related parties, and its terms, including fees payable to PRCM Advisers LLC, may not be as favorable to us as if they had been negotiated with an unaffiliated third party. In addition, we may choose not to enforce, or to enforce less vigorously, our rights under the management agreement because of our desire to maintain our ongoing relationship with PRCM Advisers LLC.

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The management agreement with PRCM Advisers LLC does not prevent PRCM Advisers LLC and its affiliates from engaging in additional management or investment opportunities. Pine River and its affiliates, including PRCM Advisers LLC, engage in additional management or investment opportunities that have overlapping objectives with us, and thus face conflicts in the allocation of resources between us and any other funds they manage for others or for their own accounts. Additionally, the ability of PRCM Advisers LLC and Pine River and their respective officers and employees to engage in other business activities reduces the time PRCM Advisers LLC spends managing our business. Our executive officers and the employees of PRCM Advisers LLC and Pine River do not spend all of their time managing our business. Our executive officers and the employees of PRCM Advisers LLC and Pine River allocate some, or a material portion, of their time to other businesses and activities. None of these individuals is required to devote a specific amount of time to our affairs. Accordingly, we compete with Pine River, its existing funds, investment vehicles, other ventures and possibly other entities in the future for the time and attention of these officers.

We may enter into additional transactions with Pine River or its affiliates. In particular, we may purchase assets from Pine River or its affiliates or make co-purchases alongside Pine River or its affiliates. These transactions may not be the result of arm s length negotiations and may involve conflicts between our interests and the interests of Pine River and/or its affiliates. There can be no assurance that any procedural protections will be sufficient to assure that these transactions will be made on terms that will be at least as favorable to us as those that would have been obtained in an arm s length transaction.

We will compete with current and future investment entities affiliated with Pine River for access to the benefits that our relationship with Pine River provides to us, including access to investment opportunities.

There are conflicts of interest in allocating investment opportunities among us and other funds, investment vehicles and ventures managed by Pine River. There is a significant overlap in our assets and investment strategies and those of Pine River s private funds, and many of the same trading and investment personnel provide services to both entities. Further, Pine River and its affiliates may in the future form additional funds or sponsor additional investment vehicles and ventures that have overlapping objectives with us and therefore may compete with us for investment opportunities and Pine River resources. It is the written policy of Pine River and PRCM Advisers LLC to allocate investment opportunities on a fair and equitable basis among all entities for which they provide investment management services. However, we cannot assure you that Pine River and PRCM Advisers LLC will always allocate every investment opportunity in a manner that is advantageous for us; indeed, we may expect that the fair and equitable allocation of investment opportunities will at times result in our receiving only a portion of, or none of, certain investment opportunities.

The loss of our access to Pine River s investment professionals and principals may adversely affect our ability to achieve our investment objectives.

We depend on PRCM Advisers LLC s access, through a shared facilities and services agreement, to the investment professionals and principals of Pine River and the information and origination opportunities generated by Pine River s investment professionals and principals during the normal course of their investment and portfolio management activities. These investment professionals and principals evaluate, negotiate, structure, close and monitor our investments and our financing activities and we depend on their continued service. The departure of a significant number of the investment professionals or principals of Pine River could have a material adverse effect on our ability to achieve our investment objectives.We are not assured of access to all of Pine River s investment professionals, or to the time or expertise of any particular members of Pine River s fixed income team. In addition, we cannot assure you that PRCM Advisers LLC will remain our manager or that we will continue to have access to Pine River s investment professionals or principals or its information and asset origination opportunities.

PRCM Advisers LLC, Pine River and our executive officers have limited experience managing a public company and as a result we may be unable to manage our public reporting requirements.

Neither PRCM Advisers LLC nor Pine River has previously managed the affairs of a publicly-listed company. Although certain of our directors and officers have public company experience, others do not, and they have not previously served together in the management of any public company. Management of a public company requires particular skills in areas such as governance, accounting, financial reporting, investor relations, systems, controls and regulatory compliance. Our relative inexperience in these areas increases the risk that our management will fail to comply with one or more requirements related to our public company status. Such failure could have materially adverse impacts on the price and liquidity of our securities.

PRCM Advisers LLC has limited experience in managing a REIT, which may hinder our ability to achieve our investment objectives or result in loss of our qualification as a REIT.

The REIT rules and regulations are highly technical and complex, and the failure to comply with these rules and regulations could prevent us from qualifying as a REIT or could force us to pay unexpected taxes and penalties. PRCM Advisers LLC has limited experience in managing a portfolio of assets under these complex rules and regulations. Prior to the merger transaction, PRCM Advisers LLC s and Pine River s officers and employees had no prior experience operating a REIT and operating a business in compliance with the numerous technical restrictions and limitations set forth in the Code or the 1940 Act applicable to REITs. The limited experience may hinder our ability to achieve our investment objectives or may result in loss of our qualification as a REIT.

Our board of directors has approved very broad investment guidelines for us and will not review or approve each investment decision made by PRCM Advisers LLC.

Our board of directors periodically reviews our investment guidelines and our investment portfolio but does not review or approve specific investments. PRCM Advisers LLC has great latitude within the broad parameters of our investment guidelines in determining our investments and investment strategies, which could result in investment returns that are substantially below expectations or that result in material losses.

The manner of determining the management fee may not provide sufficient incentive to PRCM Advisers LLC to maximize risk-adjusted returns on our investment portfolio because it is based on our stockholders equity and not on our financial performance.

PRCM Advisers LLC is entitled to receive a management fee that is based on our stockholders equity at the end of each quarter, regardless of our financial performance. Accordingly, significant management fees will be payable to PRCM Advisers LLC even if we have a net loss during a quarter. PRCM Advisers LLC s right to such compensation may not provide sufficient incentive to PRCM Advisers LLC to devote its time and effort to maximize risk-adjusted returns on our investment portfolio, which could, in turn, adversely affect our financial results. Further, the management fee structure gives PRCM Advisers LLC the incentive to maximize stockholders equity by the issuance of new common stock or the retention of existing equity, regardless of the effect of these actions on existing stockholders. In other words, the management fee structure rewards PRCM Advisers LLC primarily based on our size, and not on our returns to stockholders.

The termination of the management agreement may be difficult and costly, which may adversely affect our inclination to end our relationship with PRCM Advisers LLC.

Termination of the management agreement with PRCM Advisers LLC without cause is difficult and costly. The term cause is limited to certain specifically described circumstances. The management agreement provides that, in the absence of cause, we may only terminate it after October 28, 2012, upon the vote of at least two-thirds of all of our independent directors or by a vote of the holders of a majority of the outstanding shares of our common stock. Additionally, upon a termination by us without cause (or upon a termination by PRCM Advisers LLC due to our material breach), the management agreement requires us to pay PRCM Advisers LLC a termination payment equal to three times the sum of the annual management fee received by PRCM Advisers LLC during the 24-month period before such termination, calculated as of the end of the most recently completed fiscal quarter. This provision increases the effective cost to us of terminating our relationship with PRCM Advisers LLC, even if we believe that PRCM Advisers LLC s performance is not satisfactory.

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PRCM Advisers LLC s and Pine River s liability is limited under the management agreement, and we have agreed to indemnify PRCM Advisers LLC and its affiliates and advisers, including Pine River, against certain liabilities. As a result, we could experience poor performance or losses for which PRCM Advisers LLC and Pine River would not be liable.

Pursuant to the management agreement, PRCM Advisers LLC does not assume any responsibility other than to render the services called for thereunder and will not be responsible for any action of our board of directors in following or declining to follow its advice or recommendations. PRCM Advisers LLC and its officers, stockholders, members, managers, personnel and directors, any person controlling or controlled by PRCM Advisers LLC and any person providing sub-advisory services to PRCM Advisers LLC will not be liable to us, any of our subsidiaries, any of our directors, stockholders or partners or any subsidiary s stockholders, members or partners for acts or omissions performed in accordance with or pursuant to the management agreement, except by reason of acts constituting reckless disregard of PRCM Advisers LLC s duties under the management agreement which has a material adverse effect on us, willful misconduct or gross negligence, as determined by a final non-appealable order of a court of competent jurisdiction. We have agreed to indemnify PRCM Advisers LLC and its affiliates and sub-advisers, including Pine River, with respect to all expenses, losses, damages, liabilities, demands, charges and claims arising from acts or omissions of such indemnified parties not constituting reckless disregard of PRCM Advisers LLC s duties under the management agreement which has a material adverse effect on us, willful misconduct or gross negligence. As a result, if we experience poor performance or losses, PRCM Advisers LLC would not be liable.

Risks Related to Our Assets

We may not realize gains or income from our assets.

We seek to generate current income and capital appreciation for our stockholders. However, the assets that we acquire may not appreciate in value and, in fact, may decline in value, and the securities that we acquire may experience defaults of interest and/or principal payments. Accordingly, we may not be able to realize gains or income from our assets. Any gains that we do realize may not be sufficient to offset other losses that we experience. Any income that we realize may not be sufficient to offset our expenses.

Changes in mortgage prepayment rates may adversely affect the value of our assets.

The value of our RMBS assets is affected by prepayment rates on mortgage loans, and our investment strategy includes making investments based on our expectations regarding prepayment rates. Typically, the value of a mortgage-backed security includes market assumptions regarding the speed at which the underlying mortgages will be prepaid. Faster than expected prepayments could adversely affect our profitability, including in the following ways:

We may purchase RMBS that have a higher interest rate than the market interest rate at the time. In exchange for this higher interest rate, we may pay a premium over the par value to acquire the security. In accordance with GAAP, we may amortize this premium over the estimated term of the RMBS. If the RMBS is prepaid in whole or in part prior to its maturity date, however, we may be required to expense the premium that was prepaid at the time of the prepayment.

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

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

Prepayment rates that are faster than anticipated may increase or decrease the value of a security, depending on the type of security and the price paid to acquire the security. Prepayment rates may be affected by a number of factors including the availability of mortgage credit, the relative economic vitality of the area in which the related properties are located, the average remaining life of the loans, the average size of the remaining loans, the servicing of the mortgage loans, possible changes in tax laws, other opportunities for investment, homeowner mobility and other economic, social, geographic, demographic and legal factors. Consequently, such prepayment rates cannot be predicted with any certainty. In making investment decisions, we depend on certain assumptions based upon historical trends with respect to the relationship between interest rates and prepayments under normal market conditions. If the recent dislocations in the residential mortgage market or other developments change the way that prepayment trends have historically responded to interest rate changes, our ability to (1) assess the market value of target assets, (2) implement hedging strategies and (3) implement techniques to hedge prepayment risks would be significantly affected, which could materially adversely affect our financial position and results of operations. If we make erroneous assumptions regarding prepayment rates, we may experience significant investment losses.

A prolonged economic slowdown, a lengthy or severe recession or declining real estate values could impair our assets and harm our operations.

The risks associated with our business are more severe during periods of economic slowdown or recession, especially if these periods are accompanied by declining real estate values. The ability of a borrower to repay a loan secured by a residential property typically is dependent upon the income or assets of the borrower. During an economic slowdown, unemployment rises and increasing numbers of borrowers have difficulty in making payments on their debts, including on mortgage loans. When a recession is combined with declining real estate values, as has been the case in the recession that started in 2008, defaults on mortgages may increase dramatically.

Owners of Agency RMBS are protected from the risk of default on the underlying mortgages by guarantees from Fannie Mae, Freddie Mac or, in the case of Ginnie Mae, the U.S. Government. However, we also acquire non-Agency RMBS, which are backed by residential real property but, in contrast to Agency RMBS, the principal and interest payments are not guaranteed by GSEs or the U.S. Government. Our non-Agency RMBS investments are therefore particularly sensitive to recessions and declining real estate values.

In the event of a default on a mortgage underlying a non-Agency RMBS in our portfolio, we bear the risk of loss as a result of the potential deficiency between the value of the collateral and the debt owed on the mortgage, as well as the costs and delays of foreclosure or other remedies including the costs of maintaining and ultimately selling a property after foreclosure.

Any sustained period of increased payment delinquencies, defaults, foreclosures or losses on our non-Agency RMBS could adversely affect our revenues, results of operations, financial condition, business prospects and ability to make distributions to stockholders.

We acquire RMBS collateralized by subprime mortgage loans, which are subject to increased risks.

Among other assets, we acquire RMBS backed by collateral pools of subprime mortgage loans, which are mortgage loans that have been originated using underwriting standards that are less conservative than those used in underwriting prime mortgage loans (mortgage loans that generally conform to GSE underwriting guidelines) and Alt-A mortgage loans (mortgage loans made to borrowers whose qualifying mortgage characteristics do not conform to GSE underwriting guidelines and generally allow homeowners to qualify for a mortgage loan with reduced or alternate forms of documentation). These lower standards include mortgage loans made to borrowers having imperfect or impaired credit histories, mortgage loans where the amount of the loan at origination is 80% or more of the value of the mortgage property, mortgage loans made to borrowers with low credit scores, mortgage loans made to borrowers who have other debt that represents a large portion of their income and mortgage loans made to borrowers whose income is not required to be disclosed or verified. Due to economic conditions, including increased interest rates and lower home prices, as well as aggressive lending practices, subprime mortgage loans have in recent periods experienced increased rates of delinquency, foreclosure, bankruptcy and loss, and they are likely to continue to experience delinquency, foreclosure, bankruptcy and loss rates that may be substantially higher than those experienced by mortgage loans underwritten in a more traditional manner. In acquiring these assets, we endeavor to factor the risk of losses on the underlying mortgages into the purchase price of the asset. If we underestimate those losses, however, the performance of RMBS backed by subprime mortgage loans that we acquire could be adversely affected, which could adversely impact our results of operations, financial condition and business.

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Our portfolio of assets may be concentrated in terms of credit risk.

Although as a general policy we seek to acquire and hold a diverse portfolio of assets, we are not required to observe specific diversification criteria, except as may be set forth in the investment guidelines adopted by our board of directors. Therefore, our asset portfolio may at times be concentrated in certain property types that are subject to higher risk of foreclosure, or secured by properties concentrated in a limited number of geographic locations. To the extent that our portfolio is concentrated in any one region or type of security, downturns relating generally to such region or type of security may result in defaults on a number of our assets within a short time period, which may reduce our net income and the value of our shares and accordingly reduce our ability to pay dividends to our stockholders. The portfolio may contain other concentrations of risk, and we may fail to identify, detect or hedge against those risks, resulting in large or unexpected losses.

Our subordinated RMBS assets may be in the first loss position, subjecting us to greater risk of losses.

We invest in certain tranches of RMBS that are only entitled to a portion of the principal and interest payments made on mortgage loans underlying the securities issued by the trust. In general, losses on a mortgage loan included in such a trust will be borne first by the equity holder of the issuing trust, and then by the first loss subordinated security holder and then by the second loss mezzanine holder. We may acquire securities at every level of such a trust, from the equity holder to the most senior tranche. In the event of default and the exhaustion of any classes of securities junior to those which we acquire, our securities will suffer losses as well. In addition, if we overvalue the underlying mortgage portfolio, or if the values subsequently decline and, as a result, less collateral is available to satisfy interest and principal payments due on the related RMBS, the securities which we acquire may effectively become the first loss position behind the more senior securities, which may result in significant losses. The prices of lower credit quality securities are generally less sensitive to interest rate changes than more highly rated securities, but more sensitive to adverse economic downturns or individual issuer developments. A projection of an economic downturn could cause a decline in the price of lower credit quality securities because the ability of obligors of mortgages underlying RMBS to make principal and interest payments may be impaired. In such event, existing credit support in the securitization structure may be insufficient to protect us against loss of our principal on these securities.

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

Our operating results will depend in large part on the difference between the income from our assets, net of credit losses, and financing costs. We anticipate that, in many cases, the income from our assets will respond more slowly to interest rate fluctuations than the cost of our borrowings. Consequently, changes in interest rates, particularly short-term interest rates, may significantly influence our financial results.

Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. Interest rate fluctuations present a variety of risks, including the risk of a narrowing of the difference between asset yields and borrowing rates, flattening or inversion of the yield curve and fluctuating prepayment rates.

In a normal yield curve environment, fixed income assets, including many RMBS, decline in value if interest rates increase. If long-term rates increase significantly, not only will the market value of these assets be expected to decline, but the duration and weighted-average life of the assets could increase as well because borrowers are less likely to prepay mortgages. Further, an increase in short-term interest rates would increase the rate of interest payable on any repurchase agreements required to finance these securities.

We endeavor to hedge our exposure to changes in interest rates, but there can be no assurances that our hedges will be successful, or that we will be able to enter into or maintain such hedges. As a result, interest rate fluctuations can cause significant losses, reductions in income, and limitations on our cash available for distribution to stockholders.

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An increase in interest rates may cause a decrease in the volume of certain of our target assets, which could adversely affect our ability to acquire target assets that satisfy our investment objectives and to generate income and pay dividends.

Rising interest rates generally reduce the demand for mortgage loans due to the higher cost of borrowing. A reduction in the volume of mortgage loans originated may affect the volume of target assets available to us, which could adversely affect our ability to acquire assets that satisfy our investment objectives. Rising interest rates may also cause our target assets that were issued prior to an interest rate increase to provide yields that are below prevailing market interest rates. If rising interest rates cause us to be unable to acquire a sufficient volume of our target assets with a yield that is above our borrowing cost, our ability to satisfy our investment objectives and to generate income and pay dividends may be materially and adversely affected.

The assets in our portfolio are recorded at fair value, however there may be substantial uncertainty as to the value of certain assets.

Some of the assets in our portfolio are not publicly traded. The fair value of securities and other assets that are not publicly traded may not be readily determinable. We value these assets quarterly at fair value, as determined in accordance with ASC 820, *Fair Value Measurements and Disclosures*, which may include unobservable inputs. Because such valuations are subjective, the fair value of certain of our assets may fluctuate over short periods of time and our determinations of fair value may differ materially from the values that would have been used if a ready market for these securities existed. The value of our common stock could be adversely affected if our determinations regarding the fair value of these assets are materially higher than the values that we ultimately realize upon their disposal.

Mortgage loan modification programs and future legislative action may adversely affect the value of, and the returns on, the assets that we acquire.

The U.S. Government, through the Federal Reserve, the Federal Housing Administration and the Federal Deposit Insurance Corporation, has commenced implementation of programs designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures. The primary program that has been initiated is the Home Affordable Modification Program, or HAMP, which seeks to provide relief to homeowners whose mortgages are in foreclosure. Through January 2010, 116,000 mortgages had been permanently modified under HAMP, 76,000 more were near completion, over 1,000,000 homeowners had started trial modifications, and nearly 1,300,000 offers for trial modifications had been extended to homeowners. The programs may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans or the rate of interest payable on the loans, or to extend the payment terms of the loans. In addition, some members of Congress have indicated support for additional legislative relief for homeowners, including an amendment of the bankruptcy laws to permit the modification of mortgage loans in bankruptcy proceedings. In March 2010 the Obama administration announced that it would allocate $14 billion of TARP funds to enhance the HAMP program. The funds will be available for use in reducing principal amounts and payments owing on mortgages of unemployed homeowners who are at risk of foreclosure. Loan modifications are more likely to be used when borrowers are less able to refinance or sell their homes due to market conditions, and when the potential recovery from a foreclosure is reduced due to lower property values. Loan modifications may lead to fewer foreclosures, and reduce the losses on non-Agency RMBS arising from foreclosures, however loan modifications may also result in significant reductions in cash flows to the holders of the RMBS. We attempt to factor in the likelihood and potential consequences of loan modification programs in making our investment decisions, however we cannot assure you that our analysis will be correct. As a result, loan modification programs, as well as future legislative or regulatory actions that result in the modification of outstanding mortgage loans may adversely affect the value of, and the returns on, our assets.

Risks Related to Our Organization and Structure

Certain provisions of Maryland law could inhibit changes in control.

Certain provisions of the Maryland General Corporation Law, or the MGCL, may have the effect of deterring a third party from making a proposal to acquire us or of impeding a change in control under

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circumstances that otherwise could provide the holders of shares of our common stock with the opportunity to realize a premium over the then-prevailing market price of such shares.

We are subject to the business combination provisions of the MGCL that, subject to limitations, prohibit certain business combinations (including a merger, consolidation, share exchange, or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities) between us and an interested stockholder (defined generally as any person who beneficially owns 10% or more of our then outstanding voting stock or an affiliate or associate of ours who, at any time within the two-year period immediately prior to the date in question, was the beneficial owner of 10% or more of the voting power of our then outstanding stock) or an affiliate thereof for five years after the most recent date on which the stockholder becomes an interested stockholder. After the five-year prohibition, any business combination between us and an interested stockholder generally must be recommended by our board of directors and approved by the affirmative vote of at least (1) 80% of the votes entitled to be cast by holders of outstanding shares of our voting stock; and (2) two-thirds of the votes entitled to be cast by holders of voting stock of the corporation other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested stockholder. These super-majority vote requirements do not apply if our common stockholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares. These provisions of the MGCL do not apply to business combinations that are approved or exempted by our board of directors prior to the time that the interested stockholder becomes an interested stockholder. Pursuant to the statute, our board of directors has by resolution exempted business combinations (1) between us and any person, provided that such business combination is first approved by our board of directors (including a majority of our directors who are not affiliates or associates of such person) and (2) between us and Pine River or its affiliates. Consequently, the five-year prohibition and the super-majority vote requirements will not apply to business combinations between us and any person. As a result, any person, including Pine River, may be able to enter into business combinations with us that may not be in the best interests of our stockholders, without compliance with the super-majority vote requirements and the other provisions of the statute.

The control share provisions of the MGCL provide that control shares (defined as voting shares of stock which, if aggregated with all other shares of stock owned by the acquirer or in respect of which the acquirer is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquirer to exercise one of three increasing ranges of voting power in electing directors) acquired in a control share acquisition (defined as the direct or indirect acquisition of ownership or control of control shares) have no voting rights except to the extent approved by our stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding votes entitled to be cast by the acquirer of control shares, our officers and employees who are also our directors. Our bylaws contain a provision exempting from the control share acquisition statute any and all acquisitions by any person of shares of our stock. There can be no assurance that this provision will not be amended or eliminated at any time in the future.

The unsolicited takeover provisions of the MGCL (Title 3, Subtitle 8 of the MGCL) permit our board of directors, without stockholder approval and regardless of what is currently provided in our charter or bylaws, to implement takeover defenses, some of which (for example, a classified board) we do not currently have. These provisions may have the effect of inhibiting a third party from making an acquisition proposal for us or of delaying, deferring or preventing a change in control of us under circumstances that otherwise could provide the holders of shares of our common stock with the opportunity to realize a premium over the then current market price. Our charter contains a provision whereby we have elected to be subject to the provisions of Title 3, Subtitle 8 of the MGCL relating to the filling of vacancies on our board of directors.

Our authorized but unissued shares of common and preferred stock and the ownership limitations contained in our charter may prevent a change in control.

Our charter authorizes us to issue additional authorized but unissued shares of common or preferred stock. In addition, our board of directors may, with the approval of a majority of the entire board and without stockholder approval, amend our charter to increase or decrease the aggregate number of shares of our stock or the number of shares of stock of any class or series that we have the authority to issue, and classify or reclassify any unissued shares of common or preferred stock, and set the terms of the classified or reclassified shares. As a result, our board may establish a series of shares of common or preferred stock that could delay or prevent a transaction or a change in control that might involve a premium price for shares of our common stock or otherwise be in the best interests of our stockholders.

In addition, our charter contains restrictions limiting the ownership and transfer of shares of our common stock and other outstanding shares of capital stock. The relevant sections of our charter provide that, subject to certain exceptions, ownership of shares of our common stock by any person is limited to 9.8% by value or by number of shares, whichever is more restrictive, of our outstanding shares of common stock (the common share ownership limit), and no more than 9.8% by value or number of shares, whichever is more restrictive, of our outstanding shares of capital stock (the aggregate share ownership limit). The common share ownership limit and the aggregate share ownership limit are collectively referred to herein as the ownership limits. These charter provisions will restrict the ability of persons to purchase shares in excess of the relevant ownership limits.

Our charter contains provisions that make removal of our directors difficult, which could make it difficult for stockholders to effect changes in management.

Our charter provides that, subject to the rights of any series of preferred stock, a director may be removed only by the affirmative vote of at least two-thirds of all the votes entitled to be cast generally in the election of directors. Our charter and bylaws provide that vacancies generally may be filled only by a majority of the remaining directors in office, even if less than a quorum. These requirements make it more difficult to change management by removing and replacing directors and may prevent a change in control that is in the best interests of our stockholders.

Our rights and stockholders rights to take action against directors and officers are limited, which could limit recourse in the event of actions not in the best interests of stockholders.

As permitted by Maryland law, our charter eliminates the liability of our directors and officers to us and our stockholders for money damages, except for liability resulting from:

- actual receipt of an improper benefit or profit in money, property or services; or
- a final judgment based upon a finding of active and deliberate dishonesty by the director or officer that was material to the cause of action adjudicated.

In addition, as permitted by Maryland law and our charter, we have agreed contractually to indemnify our present and former directors and officers for actions taken by them in those capacities to the maximum extent permitted by Maryland law. Further, our bylaws require us to indemnify each present or former director or officer, to the maximum extent permitted by Maryland law, who is made, or threatened to be made, a party to any proceeding because of his or her service to us. As part of these indemnification obligations, we may be obligated to fund the defense costs incurred by our directors and officers.

Tax Risks

Our failure to qualify as a REIT would subject us to U.S. federal income tax and potentially increased state and local taxes, which would reduce the amount of cash available for distribution to our stockholders.

We have been organized and intend to operate in a manner that will enable us to qualify as a REIT for U.S. federal income tax purposes commencing with our taxable year ending December 31, 2009. We have not requested and do not intend to request a ruling from the Internal Revenue Service, or the IRS, that we qualify as a REIT. The U.S. federal income tax laws governing REITs are complex, and judicial and administrative interpretations of the U.S. federal income tax laws governing REIT qualification are limited. To qualify as a REIT, we must meet, on an ongoing basis, various tests regarding the nature of our assets and income, the ownership of our outstanding shares, and the amount of our distributions. Moreover, new legislation, court decisions or administrative guidance, in each case possibly with retroactive effect, may make it more difficult or impossible for us to qualify as a REIT. Thus, while we intend to operate so that we will qualify as a REIT, given the highly complex nature of the rules governing REITs, the ongoing importance of factual determinations, and the possibility of future changes in our circumstances, no assurance can be given that we will so qualify for any particular year. These considerations also might restrict the types of assets that we can acquire in the future.

If we fail to qualify as a REIT in any taxable year, and do not qualify for certain statutory relief provisions, we would be required to pay U.S. federal income tax on our taxable income, and distributions to our stockholders would not be deductible by us in determining our taxable income. In such a case, we might need to borrow money or sell assets in order to pay taxes. Our payment of income tax would decrease the amount of income available for distribution to stockholders. Furthermore, if we fail to maintain our qualification as a REIT, we no longer would be required to distribute substantially all of our net taxable income to stockholders. In addition, unless we were eligible for certain statutory relief provisions, we could not re-elect to qualify as a REIT until the fifth calendar year following the year in which we failed to qualify.

Complying with REIT requirements may cause us to forego otherwise attractive investment opportunities or financing or hedging strategies.

To qualify as a REIT for U.S. federal income tax purposes, we must continually satisfy various tests regarding the sources of our income, the nature and diversification of our assets, the amounts we distribute to stockholders and the ownership of our stock. To meet these tests, we may be required to forego investments we might otherwise make. We may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution, and may be unable to pursue investments that would be otherwise advantageous to us in order to satisfy the source of income or asset diversification requirements for qualifying as a REIT. Thus, compliance with the REIT requirements may hinder our investment performance.

Complying with REIT requirements may force us to liquidate otherwise profitable assets.

To qualify as a REIT, we must ensure that at the end of each calendar quarter at least 75% of the value of our assets consists of cash, cash items, government securities and designated real estate assets, including certain mortgage loans and shares in other REITs. Subject to certain exceptions, our ownership of securities, other than government securities and securities that constitute real estate assets, generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets, other than government securities and securities that constitute real estate assets, can consist of the securities of any one issuer, and no more than 25% of the value of our total securities can be represented by securities of one or more TRSs. If we fail to comply with these requirements at the end of any calendar quarter after the first calendar quarter for which we qualify as a REIT, we must generally correct such failure within 30 days after the end of the calendar quarter to avoid losing our REIT qualification. As a result, we may be required to liquidate otherwise profitable assets prematurely, which could reduce our return on assets, which could adversely affect returns to stockholders.

Potential characterization of distributions or gain on sale may be treated as unrelated business taxable income to tax exempt investors.

If (i) all or a portion of our assets are subject to the rules relating to taxable mortgage pools, (ii) we are a pension held REIT, (iii) a tax exempt stockholder has incurred debt to purchase or hold our common stock, or (iv) we purchase residual REMIC interests that generate excess inclusion income, then a portion of the distributions to and, in the case of a stockholder described in clause (iii), gains realized on the sale of common stock by such tax exempt stockholder may be subject to U.S. federal income tax as unrelated business taxable income or UBTI, under the Code.

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

The REIT provisions of the Code may limit our ability to hedge our assets and operations. Under these provisions, on an annual basis we must derive 75% of our gross income from real estate assets, and 95% of our income from real estate assets and certain other qualifying income sources, in order to maintain our REIT status. Any income that we generate from transactions intended to hedge our interest rate and currency risks will generally be excluded from gross income for purposes of the 75% and 95% gross income tests if the instrument hedges interest rate risk or foreign currency exposure on liabilities used to carry or acquire real estate or income or gain that would be qualifying income under the 75% or 95% gross income tests, and such instrument is properly identified under applicable regulations promulgated by the U.S. Treasury Department, or Treasury Regulations. In addition, any income from other hedges would generally constitute non-qualifying income for purposes of both the 75% and 95% gross income tests. As a result of these rules, we may have to limit our use of hedging techniques that might otherwise be advantageous, which could result in greater risks associated with interest rate or other changes than we would otherwise incur.

The failure of a loan subject to a repurchase agreement to qualify as a real estate asset would adversely affect our ability to qualify as a REIT.

We may enter into repurchase agreements under which we will nominally sell certain of our loan assets to a counterparty and simultaneously enter into an agreement to repurchase the sold assets. We believe that we will be treated for U.S. federal income tax purposes as the owner of the loan assets that are the subject of any such agreement notwithstanding that such agreements may transfer record ownership of the assets to the counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own the loan assets during the term of the repurchase agreement, in which case we could fail to qualify as a REIT.

REIT distribution requirements could adversely affect our ability to execute our business plan and may require us to incur debt, sell assets or take other actions to make such distributions.

In order to qualify as a REIT, we must distribute to stockholders, each calendar year, at least 90% of our REIT taxable income (including certain items of non-cash income), determined without regard to the deduction for dividends paid and excluding net capital gain. To the extent that we satisfy the 90% distribution requirement, but distribute less than 100% of our taxable income, we will be subject to U.S. federal corporate income tax on our undistributed income. In addition, we will incur a 4% nondeductible excise tax on the amount, if any, by which our distributions in any calendar year are less than a minimum amount specified under U.S. federal income tax law.

We intend to distribute our net income to stockholders in a manner intended to satisfy the 90% distribution requirement and to avoid both corporate income tax and the 4% nondeductible excise tax. Our taxable income may substantially exceed our net income as determined by GAAP or differences in timing between the recognition of taxable income and the actual receipt of cash may occur in which case we may have taxable income in excess of cash flow from our operating activities. In such event, we may generate less cash flow than taxable income in a particular year and find it difficult or impossible to meet the REIT distribution requirements in certain circumstances. In such circumstances, in order to satisfy the distribution requirement and to avoid U.S. federal corporate income tax and the 4% nondeductible excise tax in that year, we may be required to: (i) sell assets in adverse market conditions, (ii) borrow on unfavorable terms, (iii) distribute amounts that would otherwise be invested in future acquisitions, capital expenditures or repayment of debt or (iv) make a taxable distribution of our shares as part of a distribution in which stockholders may elect to receive shares or (subject to a limit measured as a percentage of the total distribution) cash, in order to comply with the REIT distribution requirements. Thus, compliance with the REIT distribution requirements may require us to take actions that may not otherwise be advisable given existing market conditions and hinder our ability to grow, which could adversely affect the value of our common stock.

Even if we qualify as a REIT, we may be required to pay certain taxes.

Even if we qualify for taxation as a REIT, we may be subject to certain U.S. federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, franchise, property and transfer taxes, including mortgage recording taxes. In addition, we will hold some of our assets through taxable subsidiary corporations, including Capitol and other TRSs. Capitol and any other TRSs or other taxable corporations in which we own an interest will be subject to U.S. federal, state and local corporate taxes. Payment of these taxes generally would reduce our cash flow and the amount available to distribute to stockholders.

Our ability to invest in and dispose of to be announced securities could be limited by our REIT qualification, and we could fail to qualify as a REIT as a result of these investments.

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

Unless we are advised by counsel that TBAs should be treated as qualifying assets for purposes of the 75% asset test, we will limit our investment in TBAs and any other non-qualifying assets to no more than 25% of our total assets at the end of any calendar quarter. Furthermore, until we are advised by counsel that income and gains from the disposition of TBAs should be treated as qualifying income for purposes of the 75% gross income test, we will limit our gains from dispositions of TBAs and any other non-qualifying income to no more than 25% of our total gross income for each calendar year. Accordingly, our ability to purchase Agency RMBS through TBAs and to dispose of TBAs, through dollar roll transactions or otherwise, could be limited.

Moreover, even if we are advised by counsel that TBAs should be treated as qualifying assets or that income and gains from dispositions of TBAs should be treated as qualifying income, it is possible that the IRS could successfully take the position that such assets are not qualifying assets and such income is not qualifying income. In that event, we could be subject to a penalty tax or could fail to qualify as a REIT if (i) the value of our TBAs, together with our non-qualifying assets for the 75% asset test, exceeded 25% of our gross assets at the end of any calendar quarter, or (ii) our income and gains from the disposition of TBAs, together with our non-qualifying income for the 75% gross income test, exceeded 25% of our gross income for any taxable year.

Although our use of TRSs may partially mitigate against the negative impact of meeting the requirements for qualification as a REIT, our ownership of and relationship with our TRSs is limited and a failure to comply with the limits would jeopardize our REIT qualification and could result in the application of a 100% excise tax.

A REIT may own up to 100% of the stock of one or more TRSs. Other than certain activities relating to lodging and healthcare facilities, a TRS generally may engage in any business and may hold assets and earn income that would not be qualifying assets or income if held or earned directly by a REIT. Overall, no more than 25% of the value of a REIT s assets may consist of stock or securities of one or more TRSs. In addition, the TRS rules limit the deductibility of interest paid or accrued by a TRS to its parent REIT to assure that the TRS is subject to an appropriate level of corporate taxation. The rules also impose a 100% excise tax on certain transactions between a TRS and its parent REIT that are not conducted on an arm s-length basis.

Capitol and other TRSs that we may form will pay U.S. federal, state and local income tax on their taxable income, and their after-tax net income will be available for distribution to us but is not required to be distributed to us. We anticipate that the aggregate value of the securities of our TRSs will be less than 25% of the value of our total assets (including our TRS securities). Furthermore, we intend to monitor the value of our respective investments in our TRSs for the purpose of ensuring compliance with TRS ownership limitations. In addition, we will review all of our transactions with TRSs to ensure that they are entered into on arm s-length terms to avoid incurring the 100% excise tax described above. There can be no assurance, however, that we will be able to comply with the 25% limitation or to avoid application of the 100% excise tax discussed above.

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

We may acquire interests in debt instruments in the secondary market for less than their face amount. The discount at which such interests in debt instruments are acquired may reflect doubts about their ultimate collectability rather than current market interest rates. The amount of such discount will nevertheless generally be treated as market discount for U.S. federal income tax purposes. Market discount on a debt instrument accrues based generally on the assumption that all future payments on the debt instrument will be made. Accrued market discount is reported as income when, and to the extent that, any payment of principal of the

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debt instrument is made. In the case of residential mortgage loans, principal payments are ordinarily made monthly, and consequently, accrued market discount may have to be included in income each month as if the debt instrument were assured of ultimately being collected in full. If we collect less on a debt instrument than its purchase price plus the market discount we had previously reported as income, we may not be able to benefit from any offsetting loss deduction in a subsequent taxable year.

Similarly, some of the mortgage-backed securities that we purchase will likely have been issued with original issue discount, or OID. We will be required to report such OID based on a constant yield method and income will accrue based on the assumption that all future projected payments due on such mortgage-backed securities will be made. If such mortgage-backed securities turn out not to be fully collectible, an offsetting loss deduction will become available only in the later year in which uncollectability is provable.

Finally, in the event that any debt instruments or mortgage-backed securities acquired by us are delinquent as to mandatory principal and interest payments, or in the event a borrower with respect to a particular debt instrument acquired by us encounters financial difficulty rendering it unable to pay stated interest as due, we may nonetheless be required to continue to recognize the unpaid interest as taxable income as it accrues, despite doubt as to its ultimate collectability. Similarly, we may be required to accrue interest income with respect to subordinate mortgage-backed securities at their stated rate regardless of whether corresponding cash payments are received or are ultimately collectible. In each case, while we would in general ultimately have an offsetting loss deduction available to us when such interest was determined to be uncollectible, the utility of that deduction would depend on our having taxable income in that later year or thereafter.

Dividends payable by REITs generally do not qualify for the reduced tax rates on dividend income from regular corporations, which could adversely affect the value of our shares.

Legislation enacted in 2003 generally reduces the maximum U.S. federal income tax rate for dividends payable to domestic stockholders that are individuals, trusts and estates to 15% through 2010. Dividends payable by REITs, however, are generally not eligible for the reduced rates. Although the reduced U.S. federal income tax rate applicable to dividend income from regular corporate dividends does not adversely affect the taxation of REITs or dividends paid by REITs, the more favorable rates applicable to regular corporate dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the shares of REITs, including our shares. Also, to the extent that tax rates change after 2010, the attractiveness of an investment in our shares may decrease, which could adversely affect the value of our securities.

We may be subject to adverse legislative or regulatory tax changes that could reduce the market price of our shares.

At any time, the U.S. federal income tax laws or regulations governing REITs or the administrative interpretations of those laws or regulations may be changed, possibly with retroactive effect. We cannot predict if or when any new U.S. federal income tax law, regulation or administrative interpretation, or any amendment to any existing U.S. federal income tax law, regulation or administrative interpretation, will be adopted, promulgated or become effective or whether any such law, regulation or interpretation may take effect retroactively. We and our stockholders could be adversely affected by any such change in, or any new, U.S. federal income tax law, regulation or administrative interpretation.

Risks Related to Our Securities

Future issuances and sales of shares of our common stock may depress the market price of our common stock or have adverse consequences for our stockholders.

Our charter provides that we may issue up to 450,000,000 shares of common stock. As of the date of this prospectus, 13,379,209 shares of common stock were issued and outstanding and 33,249,000 warrants to purchase up to 33,249,000 shares of common stock were issued and outstanding. Our 2009 equity incentive plan provides for grants of restricted common stock and other equity-based awards, subject to a ceiling of 200,000 shares available for issuance under the plan. In connection with the closing of the merger with Capitol, we granted 22,159 shares of restricted common stock to our independent directors pursuant to the 2009 equity incentive plan.

We cannot predict the effect, if any, of future issuances or sales of our common stock on the market price of our common stock. Sales of substantial amounts of common stock or the perception that such sales could occur may adversely affect the prevailing market price for our common stock.

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

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

We intend to pay quarterly distributions and to make distributions to our stockholders in an amount such that we distribute all or substantially all of our REIT taxable income in each year, subject to certain adjustments. We have not established a minimum distribution payment level and our ability to pay distributions may be adversely affected by a number of factors, including the risk factors described herein. All distributions will be made, subject to Maryland law, at the discretion of our board of directors and will depend on our earnings, our financial condition, any debt covenants, maintenance of our REIT qualification and other factors as our board of directors may deem relevant from time to time. We cannot assure you that we will achieve results that will allow us to make a specified level of cash distributions.

Our warrants may be exercised in the future, which would increase the number of shares eligible for future resale in the public market.

Outstanding redeemable warrants to purchase an aggregate of 26,249,000 shares of our common stock (issued in connection with the conversion, pursuant to the merger, of the Capitol warrants issued in Capitol s initial public offering) and warrants to purchase an aggregate of 7,000,000 shares of common stock (issued in connection with the conversion, pursuant to the merger, of the warrants sold to Capitol s officers, directors and stockholders prior to Capitol s initial public offering simultaneously with the consummation of such initial public offering) are currently exercisable at an exercise price of $11.00 per share. The warrant exercise price may be lowered under certain circumstances, including, among others, in our sole discretion at any time prior to the expiration date of the warrants for a period of not less than ten business days; provided, however, that any such reduction shall be identical in percentage terms among all of the warrants. These warrants likely will be exercised if the market price of the shares of our common stock equals or exceeds the warrant exercise price. Therefore, as long as warrants remain outstanding, there will be a drag on any increase in the price of our common stock in excess of the warrant exercise price. To the extent such warrants are exercised, additional shares of our common stock will be issued, which would dilute the ownership of existing stockholders. Further, if these warrants are exercised at any time in the future at a price lower than the book value per share of our common stock, existing stockholders could suffer substantial dilution of their investment, which dilution could increase in the event the warrant exercise price is lowered. Additionally, if we were to lower the exercise price in the near future, the likelihood of this dilution could be accelerated.

Our stock price could fluctuate and could cause you to lose a significant part of your investment.

The market price of our securities may be influenced by many factors, some of which are beyond our control, including those described above and the following:

- changes in financial estimates by analysts;

fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us;

general economic conditions;

changes in market valuations of similar companies;

regulatory developments in the United States; and

additions or departures of key personnel at Pine River.

Resulting fluctuations in our stock price could cause you to lose a significant part of your investment.

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FORWARD-LOOKING STATEMENTS

We believe that some of the information in this prospectus constitutes forward-looking statements within the definition of the Private Securities Litigation Reform Act of 1995. You can identify these statements by forward-looking words such as may, expect, anticipate, contemplate, believe, estimate, intends, and c similar words. You should read statements that contain these words carefully because they:

- discuss future expectations;
- contain projections of future results of operations or financial condition; or
- state other forward-looking information.

We believe it is important to communicate our expectations to our security holders. However, there may be events in the future that we are not able to predict accurately or over which we have no control. The risk factors and cautionary language discussed in this prospectus provide examples of risks, uncertainties and events that may cause actual results to differ materially from the expectations described by us in such forward-looking statements, including among other things:

- use of proceeds of this offering;
- changes in interest rates;
- changes in mortgage prepayment rates;
- the timing of credit losses within our portfolio;
- our exposure to adjustable-rate and negative amortization mortgage loans;
- the state of the credit markets and other general economic conditions, particularly as they affect the price of earning assets and the credit status of borrowers;
- the concentration of the credit risks we are exposed to;
- legislative and regulatory actions affecting the mortgage industry or our business;
- the availability of target assets for purchase at attractive prices;
- the availability of financing for our portfolio, including the availability of repurchase agreement financing;
- declines in home prices;
- increases in mortgage payment delinquencies;
- changes in liquidity in the market for real estate securities, the re-pricing of credit risk in the capital markets, inaccurate ratings of securities by rating agencies, rating agency downgrades of securities, and increases in the supply of real estate securities available-for-sale;
- changes in the values of securities we own and the impact of adjustments reflecting those changes on our income statement and balance sheet, including our stockholders equity;
- our ability to generate the amount of cash flow we expect from our investment portfolio;
- changes in our investment, financing, and hedging strategies and the new risks that those changes may expose us to;
- changes in the competitive landscape within our industry, including changes that may affect our ability to retain or attract personnel;
- our ability to manage various operational risks associated with our business;
- our ability to maintain appropriate internal controls over financial reporting;

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- our ability to establish, adjust and maintain appropriate hedges for the risks in our portfolio; and
- limitations imposed on our business due to our REIT status and our status as exempt from registration under the 1940 Act.

You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this prospectus.

All forward-looking statements included herein attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Except to the extent required by applicable laws and regulations, we undertake no obligations to update these forward-looking statements to reflect events or circumstances after the date of this prospectus or to reflect the occurrence of unanticipated events.

Before you make an investment decision, you should be aware that the occurrence of the events described in the *Risk Factors* section and elsewhere in this prospectus may adversely affect us.

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USE OF PROCEEDS

We are offering 14,000,000 shares of our common stock at the assumed public offering price of $9.09 per share (based on our last reported sales price on April 5, 2010). We estimate that the net proceeds we will receive from selling common stock in this offering will be approximately $120.4 million, after deducting the portion of the assumed underwriting discounts and commissions payable by us and estimated offering expenses of approximately $6.8 million (or, if the underwriters exercise their over-allotment option in full, approximately $138.6 million, after deducting the portion of the assumed underwriting discounts and commissions payable by us and estimated offering expenses of approximately $7.8 million).

We plan to use all the net proceeds from this offering above to acquire our target assets in accordance with our objectives and strategies described in this prospectus. See *Business Our Business Investment Guidelines and Strategy*. Our focus will be on purchasing Agency RMBS, non-Agency RMBS, and other assets, subject to our investment guidelines and to the extent consistent with maintaining our REIT qualification. PRCM Advisers LLC will make determinations as to the percentage of our assets that will be invested in each of our target assets. Its decisions will depend on prevailing market conditions and may change over time in response to opportunities available in different interest rate, economic and credit environments. Until appropriate assets can be identified, PRCM Advisers LLC may invest the net proceeds from this offering in interest-bearing short-term investments, including funds which are consistent with our intention to qualify as a REIT. These investments are expected to provide a lower net return than we will seek to achieve from our target assets. Prior to the time we have fully used the net proceeds of this offering to acquire our target assets, we may fund our quarterly distributions out of such net proceeds.

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PUBLIC MARKET FOR OUR COMMON STOCK

Our common stock is listed on the NYSE Amex under the symbol TWO. Prior to the consummation of the merger with Capitol on October 28, 2009, there had been no public trading market for our common stock. As of April 5, 2010, 13,379,209 shares of our common stock were issued and outstanding, and we had one registered holder and as of March 26, 2010 we had approximately 859 beneficial owners of our common stock. On April 5, 2010, the closing price of our common stock, as reported on the NYSE Amex, was $9.09. The following table sets forth the high and low sales prices for our common stock on the NYSE Amex for the periods indicated and the dividends declared per share of our common stock:

Period	High	Low
October 29, 2009 to December 31, 2009	$ 10.10	$ 8.70
January 1, 2010 to April 5, 2010	$ 10.23	$ 8.71

Date Common Dividends Declared	Amount Per Share	Date of Payment
December 21, 2010	$ 0.26	January 26, 2010
March 12, 2010	$ 0.36	April 23, 2010 (1)

(1) Purchasers of our common stock in the offering will not receive this dividend.

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DIVIDEND POLICY

We intend to elect and qualify to be taxed as a REIT for U.S. federal income tax purposes commencing with our taxable year ending December 31, 2009. U.S. federal income tax law requires that a REIT distribute with respect to each year at least 90% of its REIT taxable income, determined without regard to the deduction for dividends paid and excluding any net capital gain. If our cash available for distribution is less than 90% of our REIT taxable income, we could be required to sell assets or borrow funds to pay cash dividends or we may make a portion of the required dividend in the form of a taxable stock dividend or dividend of debt securities. We will generally not be required to pay dividends with respect to activities conducted through any domestic TRS. For more information, see *U.S. Federal Income Tax Considerations U.S. Federal Income Tax Considerations of Two Harbors as a REIT Taxation of Two Harbors General.*

To satisfy the requirements to qualify as a REIT and generally not be subject to U.S. federal income and excise tax, we intend to pay regular quarterly dividends of all or substantially all of our taxable income to holders of our common stock out of assets legally available therefor. The timing and amount of any dividends we pay to holders of our common stock will be at the discretion of our board of directors and will depend upon various factors, including our actual and projected results of operations, financial condition, liquidity and business, our debt and preferred stock covenants, maintenance of our REIT qualification, applicable provisions of the MGCL and such other factors as our board of directors deems relevant. On December 21, 2009, we declared a dividend of $0.26 per share of common stock to stockholders of record as of December 31, 2009 and paid such dividend on January 26, 2010. On March 12, 2010, our board of directors declared a dividend of $0.36 per share, payable to stockholders of record on April 23, 2010. Purchases of our common stock in the offering will not receive this dividend. Our results of operations, financial condition, cash flows and liquidity will, in turn, be affected by various factors, including the net interest and other income from our portfolio, our operating expenses and any other expenditures. For more information regarding risk factors that could materially adversely affect our results of operations, financial condition, cash flows, liquidity, business and prospects, see *Risk Factors.*

We anticipate that our dividends generally will be taxable as ordinary income to our stockholders, although a portion of the dividends may be designated by us as qualified dividend income or capital gain or may constitute a return of capital. We will furnish annually to each of our stockholders a statement setting forth dividends paid during the preceding year and their characterization as ordinary income, return of capital, qualified dividend income or capital gain. For more information, see *U.S. Federal Income Tax Considerations Taxation of Taxable U.S. Stockholders.*

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CAPITALIZATION

The following table sets forth (1) our actual capitalization at December 31, 2009 and (2) our capitalization as adjusted to reflect the effect of the sale of our common stock in this offering at an assumed offering price of $9.09 per share (based on the last reported sales price on April 5, 2010), after deducting the underwriting discount and estimated offering expenses payable by us. You should read this table together with our consolidated financial statements and the accompanying notes, and *Management s Discussion and Analysis of Financial Condition and Results of Operations* and *Use of Proceeds* included elsewhere in this prospectus.

	As of December 31, 2009	
	Actual[(1)]	As adjusted for this Offering[(2)]
Stockholders Equity		
Common stock, par value $0.01 per share, 450,000,000 shares authorized; 13,379,209 issued and outstanding as of December 31, 2009, actual and 27,379,209 shares outstanding as adjusted	$133,792	$273,792
Preferred stock, par value $0.01 per share, 50,000,000 shares authorized; no shares issued and outstanding as of December 31, 2009		
Additional paid-in capital	131,756,484	252,043,484[(3)]
Accumulated other comprehensive loss	(949,728)	(949,728)
Cumulative earnings (losses)	(5,735,425)	(5,735,425)
Cumulative distributions to stockholders	(3,484,356)	(3,484,356)
Total capitalization	$121,720,767	$242,147,767

(1) Certain amounts have been reclassified for purposes of this capitalization table as compared to the audited consolidated balance sheet.

(2) Does not include the underwriters option to purchase up to 2,100,000 additional shares.

(3) Represents additional paid in capital net of issuance costs.

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SELECTED FINANCIAL DATA

We are providing the following summary historical financial information to assist you in your analysis of the offering covered by this prospectus. The following table presents selected historical financial information as of December 31, 2009 and December 31, 2008, and for the period from June 26, 2007 (date of inception of Capitol) to December 31, 2007. Our results prior to the merger in 2009 and in 2008 and 2007 represent the historical results of Capitol, the accounting acquirer in the merger completed on October 28, 2009. Certain amounts for prior periods have been reclassified to conform to the 2009 presentation.

Our selected financial data set forth below should be read in conjunction with our consolidated financial statements and the accompanying notes, and *Management s Discussion and Analysis of Financial Condition and Results of Operations* contained elsewhere herein. The historical results included below and elsewhere in this prospectus are not indicative of our future performance.

Income Statement Data:	At or for the Year Ended December 31, 2009(1)	2008(1)	At or for the Period from June 26, 2007 (inception) through December 31, 2007(1)
Interest income	$2,866,053	$4,442,222	$1,474,220
Interest expense	131,510		
Net interest income	2,734,543	4,442,222	1,474,220
Other income:			
Gain on sale of investment securities, net	335,966		
Unrealized gain on interest rate swap agreements	363,666		
Total other income	699,632		
Expenses:			
Management fees	325,654		
Operating expenses:			
Costs associated with business combination	9,572,218		
Costs associated with Capitol as a development stage company	1,346,747	1,059,606	140,999
Other operating expenses	1,252,378		
Total expenses	12,496,997	1,059,606	140,999
Net (loss) income before income taxes	(9,062,822)	3,382,616	1,333,221
Benefit from (provision for) income taxes	318,291	(1,088,083)	(618,648)
Net (loss) income	$(8,744,531)	$2,294,533	$714,573
Accretion of Trust Account income relating to common stock subject to possible conversion	(92,872)	(235,706)	
Net (loss) income attributable to other common stockholders	$(8,837,403)	$2,058,827	$714,573
Basic and diluted (loss) earnings per share	$(0.39)	$0.08	$0.06
Dividends declared per common share	$0.26	$	$
Basic and diluted weighted average shares outstanding	22,941,728	24,936,558	11,602,789

Balance Sheet Data:			
Available-for-sale securities	$494,464,867	$	$
Total assets	538,365,409	262,095,130	260,303,897
Repurchase agreements	411,892,510		
Total stockholders equity	121,720,767	184,161,891	182,103,064

(1) Capitol, the accounting acquirer in the merger completed on October 28, 2009, was formed on June 26, 2007 as a development stage company. As such, our results of operations are presented for only the periods set forth above. Comparability of the financial data is affected by the merger with Capitol.

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	For the Year Ended December 31, 2009[(1)]	For the Year Ended December 31, 2008[(1)]	For the Period From June 26, 2007 (Inception) through December 31, 2007[(1)]
Cash Flow Data:			
Net cash (used in) provided by operating activities	$(16,240,207)	$1,714,762	$1,389,340
Net cash (used in) provided by investing activities	$(245,301,729)	$602,417	$(259,820,845)
Net cash (used in) provided by financing activities	$284,868,673	$(511)	$258,892,980
Net (decrease) increase in cash	$23,326,737	$2,316,668	$461,475

(1) Capitol, the accounting acquirer in the merger completed on October 28, 2009 was formed on June 26, 2007 as a development stage company. As such, our results of operations are presented for only the periods set forth above. Comparability of the financial data is affected by the merger with Capitol.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the consolidated financial statements and accompanying notes included elsewhere in this prospectus.

General

We are a recently formed REIT that focuses on investing in, financing and managing RMBS.

Our objective is to provide attractive risk-adjusted returns to our investors over the long term, primarily through dividends and secondarily through capital appreciation. We intend to acquire and manage a portfolio of mortgage-backed securities, focusing on security selection and the relative value of various sectors within the mortgage market. We seek to invest in the following asset classes:

- Agency RMBS.
- Non-Agency RMBS.
- Financial assets other than RMBS, comprising approximately 5% to 10% of the portfolio.

We are externally managed and advised by PRCM Advisers LLC, a subsidiary of Pine River. We expect to deploy moderate leverage as part of our investment strategy, through, with respect to Agency RMBS, short-term borrowings structured as repurchase agreements, and with respect to non-Agency RMBS, through both repurchase agreements and other available private funding sources.

We are a Maryland corporation that commenced operations upon completion of the merger transaction with Capitol on October 28, 2009. We intend to elect and qualify to be taxed as a REIT for U.S. federal income tax purposes, commencing with our taxable period ended December 31, 2009. We generally will not be subject to U.S. federal income taxes on our taxable income to the extent that we annually distribute all of our net taxable income to stockholders and maintain our intended qualification as a REIT. We also intend to operate our business in a manner that will permit us to maintain our exemption from registration under the 1940 Act.

Overview

Our 2009 efforts were focused on three strategic objectives that we believe position us for long term success.

Deploying capital efficiently. After completion of the merger transaction, our objective was to deploy capital rapidly but prudently, focusing on assets with attractive risk-adjusted returns. We believe we have accomplished this goal: our capital was substantially fully invested as of December 2009.

Managing a portfolio to generate attractive returns with balanced risks. Our portfolio approach manages to a low level of interest rate and mortgage spread duration and focuses on positive prepayment upside. Through a diversified portfolio of Agency and non-Agency RMBS in combination with derivative hedging instruments, we believe this balanced risk within our portfolio is critical to providing an attractive return to our stockholders.

Establishing systems and controls. We have focused on building effective systems and controls in the areas of operations, accounting, information technology and investor relations. In 2009, we worked to build automated systems and Sarbanes-Oxley compliant processes. We have accomplished the essential aspects of this goal, although work continues in these areas.

Factors Affecting our Operating Results

Our net interest income will include income from our RMBS portfolio and will reflect the amortization of purchase premiums and accretion of purchase discounts. Net interest income will fluctuate primarily as a result of changes in market interest rates, our financing costs, and prepayment speeds on our assets. Interest rates, financing costs and prepayment rates vary according to the type of investment, conditions in the

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financial markets, competition and other factors, none of which can be predicted with any certainty. Our operating results will also be affected by default rates and credit losses with respect to the mortgage loans underlying our non-Agency RMBS.

Fair Value Measurement

ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It also establishes three levels of input to be used when measuring fair value:

Level 1	Inputs are quoted prices in active markets for identical assets or liabilities as of the measurement date. Additionally, the entity must have the ability to access the active market and the quoted prices cannot be adjusted by the entity.
Level 2	Inputs include quoted prices in active markets for similar assets or liabilities; quoted prices in inactive markets for identical or similar assets or liabilities; or inputs that are observable or can be corroborated by observable market data by correlation or other means for substantially the full-term of the assets or liabilities.
Level 3	Unobservable inputs are supported by little or no market activity. The unobservable inputs represent management s best assumptions of how market participants would price the assets and liabilities. Generally, Level 3 assets and liabilities are valued using pricing models, discounted cash flow methodologies, or similar techniques that require significant judgment or estimation.

We follow the fair value hierarchy set forth above in order to prioritize the data utilized to measure fair value. We strive to obtain quoted market prices in active markets (Level 1 inputs). If Level 1 inputs are not available, we will attempt to obtain Level 2 inputs, observable market prices in inactive markets or derive the fair value measurement using observable market prices for similar assets or liabilities. When neither Level 1 nor Level 2 inputs are available, we use Level 3 inputs and independent pricing service models to estimate fair value measurements. At December 31, 2009, approximately 91.9% of total assets, or $494.8 million, consisted of financial instruments recorded at fair value. Approximately 0.4% of total assets, or $2.1 million of the assets reported at fair value were valued using Level 3 inputs. See Note 7 to the Consolidated Financial Statements, included in this prospectus, for descriptions of valuation methodologies used to measure material assets and liabilities at fair value and details of the valuation models, key inputs to those models and significant assumptions utilized.

A significant portion of our assets and liabilities are at fair value and therefore our consolidated balance sheet and income statement are significantly affected by fluctuations in market prices. Although we execute various hedging strategies to mitigate our exposure to changes in fair value, we cannot fully eliminate our exposure to volatility caused by fluctuations in market prices. Starting in 2007, markets for asset-backed securities, including RMBS, have experienced severe dislocations. While these market disruptions continue, our assets and liabilities will be subject to valuation adjustment as well as changes in the inputs we use to measure fair value.

For the three and twelve months ended December 31, 2009, our interest rate swap agreement accounted as a trading instrument favorably impacted our financial results. The derivative change in fair value was a result of increased LIBOR and corresponding counterparty borrowing rates at the end of the fiscal year. Any temporary change in the fair value of our available-for-sale real estate securities is recorded as a component of accumulated other comprehensive income and does not impact our earnings.

We have numerous internal controls in place to help ensure the appropriateness of fair value measurements. Significant fair value measures are subject to detailed analytics, management review and approval. Our entire asset portfolio is priced by third-party brokers at the bid side of the market, and/or by independent pricing providers. We strive to obtain multiple market data points for each valuation. By utilizing bid side pricing, certain assets, especially the most recent purchases, may realize a markdown due to the bid-offer spread. To the extent that this occurs, any economic effect of this would be reflected in accumulated other comprehensive income. Further, we back test the fair value measurements provided by the

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pricing providers against actual performance. We also monitor the market for recent trades, market surveys, or other market information that may be used to benchmark pricing provider inputs.

Considerable judgment is used in forming conclusions and estimating inputs to our Level 3 fair value measurements. Level 3 inputs such as interest rate movements, prepayments speeds, credit losses and discount rates are inherently difficult to estimate. Changes to these inputs can have a significant affect on fair value measurements. Accordingly, our estimates of fair value are not necessarily indicative of the amounts that would be realized on the ultimate sale or exchange.

Critical Accounting Estimates

The preparation of financial statements in accordance with GAAP requires us to make certain judgments and assumptions, based on information available at the time of our preparation of the financial statements, in determining accounting estimates used in preparation of the statements. Our significant accounting policies are described in Note 2 to the consolidated financial statements, included elsewhere in this prospectus.

Accounting estimates are considered critical if the estimate requires us to make assumptions about matters that were highly uncertain at the time the accounting estimate was made and if different estimates reasonably could have been used in the reporting period or changes in the accounting estimate are reasonably likely to occur from period to period that would have a material impact on our financial condition, results of operations or cash flows.

Classification of Investment Securities and Valuations of Financial Instruments

Our RMBS investments consist primarily of Agency RMBS and non-Agency RMBS that we classify as available-for-sale. Our RMBS classified as available-for-sale are carried at their fair value, with changes in fair value recorded through accumulated other comprehensive income/(loss), a component of stockholders equity, rather than through earnings. We do not intend to hold any of our investment securities for trading purposes; however, if our securities were classified as trading securities, there could be substantially greater volatility in our earnings, as changes in the fair value of securities classified as trading are recorded through earnings.

When the estimated fair value of an AFS security is less than amortized cost, we consider whether there is an other-than-temporary impairment, or OTTI, in the value of the security that is required to be recognized in the statement of operations. The determination of whether a security is other-than-temporarily impaired involves judgments and assumptions based on subjective and objective factors. Consideration is given to whether we (1) have the intent to sell the investment securities, (2) are more likely than not to be required to sell the investment securities before recovery, or (3) do not expect to recover the entire amortized cost basis of the investment securities. Investments with unrealized losses are not considered other-than-temporarily impaired if we have the ability and intent to hold the investments for a period of time, to maturity if necessary, sufficient for a forecasted market price recovery up to or beyond the amortized cost basis of the investments. If an impairment is determined to be solely driven by the inability to fully recover the entire amortized cost basis over the remaining life of the security, the security is further analyzed for credit loss (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, is then recognized in the statement of operations, while the balance of impairment related to other factors is recognized in other comprehensive income.

The methods used by us to estimate fair value may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while we believe that our valuation methods are appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. We use inputs that are current as of the measurement date, which in periods of market dislocation, may have reduced price transparency.

Interest Income Recognition

Our interest income on our Agency RMBS and non-Agency RMBS is accrued based on the actual coupon rate and the outstanding principal balance of such securities. Premiums and discounts are amortized or accreted into interest income over the lives of the securities using the effective yield method, as adjusted for actual prepayments.

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Our interest income on our non-Agency RMBS securities rated below AA, including unrated securities, is recognized in accordance with estimated cash flows. Cash flows from a security are estimated applying assumptions used to determine the fair value of such security and the excess of the future cash flows over the investment are recognized as interest income under the effective yield method. We review and, if appropriate, make adjustments to our cash flow projections at least quarterly and monitor these projections based on input and analysis received from external sources, internal models, and our judgment about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in interest income recognized on, or the carrying value of, such securities.

For non-Agency securities purchased at a discount, we account for differences between contractual cash flows and cash flows expected to be collected from our initial investment in debt securities acquired if those differences are attributable, at least in part, to credit quality. We limit the yield that may be accreted (accretable yield) to the excess of an estimate of undiscounted expected principal, interest, and other cash flows (cash flows expected at acquisition to be collected) over the initial investment. The excess of contractual cash flows over cash flows expected to be collected (nonaccretable difference or designated credit reserve) is not recognized as an adjustment of yield, loss accrual, or valuation allowance. Subsequent increases in cash flows expected to be collected is recognized prospectively through adjustment of the yield over the remaining life of the security. Decreases in cash flows expected to be collected are recognized as an impairment.

Derivative Financial Instruments and Hedging Activities

We apply the provisions of ASC 815, *Derivatives and Hedging*, which requires an entity to recognize all derivatives as either assets or liabilities in the balance sheets and to measure those instruments at fair value. The fair value adjustments of our current derivative instruments affect net income as the hedge for accounting purposes is being treated as an economic, or trading, hedge and not as a qualifying hedging instrument.

Derivatives are used for hedging purposes rather than speculation. We rely on internal models corroborated by quotations from a third party to determine these fair values. If our hedging activities do not achieve their desired results, our reported earnings may be adversely affected.

Income Taxes

Our financial results are generally not expected to reflect provisions for current or deferred income taxes, except for those taxable benefits or provisions recognized by our TRS. We plan to operate in a manner that will allow us to qualify for taxation as a REIT. As a result of our expected REIT qualification, we do not generally expect to pay U.S. federal corporate level taxes. Many of the REIT requirements, however, are highly technical and complex. If we were to fail to meet the REIT requirements, we would be subject to U.S. federal, state and local income taxes.

Market Conditions and Outlook

The 2009 calendar year experienced numerous regulatory developments in an effort to stabilize economic conditions and increase liquidity in the financial markets. These actions were in response to the significant adverse changes in the financial markets beginning in 2007 and continuing into 2010, which included housing market contractions, credit concerns and a reduction in the source of available liquidity in the capital markets. Certain of these regulatory actions have on-going impact on the valuations and expected returns of our RMBS portfolio. These regulatory developments include:

In December 2009, the US Treasury announced an amendment to the GSE Preferred Stock Purchase Program. This amendment primarily addresses the allowable portfolio sizes of Fannie Mae and Freddie Mac, and requirements for shrinking their asset size. The US Treasury announced that it would provide unlimited capital to Fannie Mae and Freddie Mac into 2012 to ensure their solvency and viability, but the long-term prospects of these entities is unclear. To the extent that the role of Fannie Mae and Freddie Mac as investors in Agency RMBS diminishes over time, it could affect the value of all RMBS, negatively impacting the value of the assets held in our portfolio, increasing the realized yields on Agency RMBS, or both.

In an attempt to lower mortgage rates and enable borrowers to refinance and lower mortgage payments, in November 2008 the Federal Reserve initiated an Agency RMBS purchase program, which now provides for purchases of up to $1.25 trillion. The program was completed on March 31, 2010. We are unable to predict whether or when the US Treasury or the Federal Reserve will make further interventions in the Agency RMBS markets, or what impact, if any, such actions could have on the RMBS markets, the securities we hold, our business, results of operations and financial condition.

In March 2009, the U.S. Treasury, the Federal Deposit Insurance Corporation and the Federal Reserve announced the creation of the Public-Private Investment Program, or PPIP. This program involves the government investing alongside and providing financing for the purchases of non-Agency RMBS and commercial mortgage backed securities by certain newly-formed investment partnerships. In July 2009, the Treasury announced that it will invest up to $30 billion in equity and debt issued by public and private investment funds, or PPIFs, and announced that it had selected nine asset managers to manage these PPIFs. So far the PPIP program has not had a significant impact on the RMBS markets, but the PPIFs can be expected to increase the competition for senior RMBS assets, which could cause prices of these assets to rise. Higher prices may result in lower effective yields on assets that we may consider for purchase and also potentially higher values for our existing Senior RMBS portfolio.

The U.S. Government has encouraged programs designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures, including the Home Affordable Mortgage Modification Program, or HAMP, among other programs. In March 2010 the Obama administration announced that it would allocate $14 billion of TARP funds to enhance the HAMP program. The funds will be available for use in reducing principal amounts and payments owing on mortgages of unemployed homeowners who are at risk of foreclosure. These homeowner assistance programs may involve the modification of mortgage loans to reduce the principal amount of the loans (through forbearance and/or forgiveness) or the rate of interest payable on the loans, or may extend the payment terms of the loans. They may also allow for streamlined financing, thus increasing prepayments, or for a delay in foreclosures, thus potentially altering the timing and amount of cash flows to certain securities. In general, these homeowner assistance programs, as well as future legislative or regulatory actions, may affect the value of, and the returns on, our RMBS portfolio. To the extent that these programs are successful and fewer borrowers default on their mortgage obligations, the actual default rates realized on our non-Agency RMBS may be less than the default assumptions made by us at the purchase of such non-Agency RMBS. This could cause the realized yields on our non-Agency RMBS portfolio to be higher than expected at time of purchase. Conversely, if these programs lead to forced reductions in principal, all affected RMBS could decrease in value.

On February 10, 2010, Fannie Mae announced its intent to increase significantly its purchases of delinquent loans from its single-family RMBS trusts. Under its single-family RMBS trust documents, Fannie Mae has the option to purchase, from its RMBS trusts, loans that are delinquent four or more consecutive monthly payments. Additionally, on the same day, Freddie Mac announced that it will purchase substantially all mortgage loans delinquent 120 days or more from its related fixed-rate and adjustable-rate mortgage Participation Certificate securities. We expect a negligible impact on our portfolios as a result of these announcements.

We believe our blended Agency and non-Agency strategies, and our trading expertise, will allow us to navigate the dynamic characteristics of the RMBS environment while these and any future regulatory efforts take shape. Having a diversified portfolio allows us to balance risks, most specifically the volatility and impacts generated by uncertainty in interest rates, changes in prepayments, increases in homeowner defaults and home price depreciation, which may result in either a reduced or increased cost of funds.

Risk-adjusted returns in our Agency RMBS portfolio will decline if we are required to pay higher purchase premiums due to lower interest rates or additional liquidity in the market (including liquidity from the Federal Reserve s purchases of Agency RMBS). Returns are also affected by the possibility of rising interest rates. We expect that the majority of our assets will remain in whole-pool Agency RMBS, due to the long-term attractiveness of the asset class and the need to preserve our exemption under the 1940 Act.

Interest-only Agency securities also provide a complementary investment and risk-management solution to our principal and interest Agency bond investments.

The substantial fear in the non-Agency RMBS market and lack of liquidity which drove price declines in late 2008 and 2009 created an investment opportunity which has attracted a substantial amount of new capital to the sector. This new pool of capital and other potential factors, such as the future availability of leverage from the government s PPIP, contributed to the upward movement in RMBS prices during the last half of 2009, which generally has reduced the potential returns for non-Agency RMBS bonds. However, consistent with our Agency portfolio strategy, we believe the marketplace continues to offer targeted opportunities as the markets contract and expand with the development of various government programs.

The following table provides the carrying value of our portfolio by product type:

	As of December 31, 2009		
Agency Bonds			
Fixed Rate Bonds	$ 112,378,746	22.7	%
Hybrid ARMs	305,441,270	61.8	%
Total Agency	417,820,016	84.5	%
Non-Agency Bonds			
Senior Bonds	54,091,629	10.9	%
Mezzanine Bonds	22,553,222	4.6	%
Total Non-Agency	76,644,851	15.5	%
Total	$ 494,464,867		

Prepayment Speeds and Volatility due to Interest Rates

The initiation of HAMP-related buyouts has led many analysts to expect a significant increase in prepayments speeds, however we take a contrarian view. We do not expect housing prices to fully stabilize in 2010 and this, combined with stagnant unemployment rates, housing inventory increases and the potential end of government support, leads us to expect that there will not be a significant increase in prepayment speeds in 2010. Nonetheless, we believe our portfolio approach is well positioned to respond to a variety of market scenarios.

Although we are unable to predict the movement in interest rates in 2010 and beyond, our blended Agency and non-Agency portfolio strategy is intended to generate attractive yields with a low level of sensitivity to yield curve, prepayments and interest rate cycles. Our portfolio has a mixture of fixed and hybrid/adjustable rate terms, which we use to manage interest rate risk.

Our Agency bond portfolio is subject to inherent prepayment risk: generally, a decline in interest rates that lead to rising prepayment speeds will cause the market value of our interest-only securities to deteriorate, but will cause the market value of our fixed coupon Agency pools to increase. The inverse relationship occurs when interest rates increase and prepayments slow. In the fourth quarter of 2009, we executed on a targeted bond purchase strategy to reduce this prepayment or interest rate risk, which included bonds with explicit prepayment protection and seasoned bonds reflecting less prepayment risk due to previously experienced high levels of refinancing.

The following table provides the carrying value of our agency bond portfolio by vintage and prepayment protection:

	As of December 31, 2009		
	Fixed Rate	Hybrid ARMs	Total Agency RMBS
Pre-pay lock-out or penalty-based	$ 64,004,507	$ 47,682,269	$ 111,686,776
Pre-2002 vintages	31,343,558	32,766,139	64,109,697
2002 2005 vintages	12,330,482	157,289,831	169,620,313
2006 and subsequent vintages	4,700,199	67,703,031	72,403,230
Total	$ 112,378,746	$ 305,441,270	$ 417,820,016

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We are offsetting a portion of the Agency exposure to prepayment speeds through our non-Agency portfolio. Our non-Agency bond yields are expected to increase if prepayment rates on such assets exceed our prepayment assumptions. To the extent that prepayment speeds increase due to macroeconomic factors, we expect to benefit from the ability to recognize the income from the heavily discounted bond prices that principally arose from credit or payment default expectations.

The following table provides discount information on our non-Agency bond portfolio:

	As of December 31, 2009		
	Senior	Mezzanine	Total
Face Value	$ 110,687,783	$ 55,892,526	$ 166,580,309
Unamortized discount			
Designated credit reserve	(22,709,996)	(27,476,627)	(50,186,623)
Unamortized net discount	(34,420,207)	(6,629,531)	(41,049,738)
Amortized Cost	$ 53,557,580	$ 21,786,368	$ 75,343,948

Credit Losses

Although our Agency portfolio is supported by U.S. government agency and federally chartered corporation guarantees of payment of principal and interest, we are exposed to credit risk in our non-Agency RMBS portfolio. However, the credit support built into RMBS deal structures is designed to provide a level of protection from potential credit losses. In addition, the discounted purchase prices paid on our non-Agency RMBS assets provide additional insulation from credit losses in the event we receive less than 100% of par on such assets. We evaluate credit risk on our non-Agency investments through a comprehensive selection process, which is predominantly focused on quantifying and pricing credit risk. We review our non-Agency RMBS based on quantitative and qualitative analysis of the risk-adjusted returns on such investments. We evaluate each investment s credit risk through our initial modeling and scenario analysis and through on-going asset surveillance. At purchase, we estimate the portion of the discount we do not expect to recover and factor that into our expected yield and accretion methodology. Nevertheless, unanticipated credit losses could occur, adversely impacting our operating results.

Counterparty Exposure and Leverage Ratio

We monitor counterparty exposure in our broker, banking and lending counterparties on a daily basis. Our broker and banking counterparties represent several well capitalized organizations and we attempt to manage our cash balances across these organizations to reduce our exposure to a single counterparty.

In relation to our lending counterparties, we have entered into repurchase agreements with six counterparties as of December 31, 2009 and we are in negotiations with several others to further diversify our relationships. As of December 31, 2009, we had a debt to equity ratio of 3.4 times which supports our hybrid portfolio investment strategy. As of December 31, 2009, we had approximately $49.6 million of unpledged non-Agency securities and an overall estimated unused borrowing capacity of approximately $29.8 million. If borrowing rates and collateral requirements change in 2010, we are positioned to adjust to higher interest rates with less earnings volatility than a more levered organization.

Summary of Results of Operations and Financial Condition

Our reported GAAP net loss attributable to common stockholders was $8.8 million ($0.39 per share) for 2009 as compared to a GAAP net income attributable to common stockholders of $2.1 million ($0.08 per share) for 2008. Our GAAP book value per diluted common share was $9.08 at December 31, 2009, an increase from $7.39 book value per common share at December 31, 2008.

Our results for 2009 reflect the costs associated with the merger transaction of $9.6 million and costs associated with Capitol as a development stage company prior to the merger transaction of $1.3 million. Excluding these merger transaction and development stage company costs, net of a reduction in tax benefits of $0.4 million, we would have reported a GAAP net income for 2009 of $1.7 million. We believe this non-GAAP financial measure is useful because the excluded costs will not be incurred on a going forward basis.

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Our results for 2008 and 2007 represent the historical results of Capitol as a development stage company with no operations. The net income for 2008 and 2007 of $2.1 million and $0.7 million, respectively, reflected interest on money market funds.

The following table presents the components of our net (loss) income for 2009, 2008 and for the period from June 26, 2007 (inception) through December 31, 2007.

	Years Ended December 31,		Period from June 26, 2007 (inception) through December 31,
	2009	2008	2007
Interest income	$2,866,053	$4,442,222	$1,474,220
Interest expense	131,510		
Net interest income	2,734,543	4,442,222	1,474,220
Other income:			
Gain on sale of investment securities, net	335,966		
Unrealized gain on interest rate swap agreements	363,666		
Total other income	699,632		
Expenses:			
Management fees	325,654		
Operating expenses:			
Costs associated with business combination	9,572,218		
Costs associated with Capitol as a development stage company	1,346,747	1,059,606	140,999
Other operating expenses	1,252,378		
Total expenses	12,496,997	1,059,606	140,999
Net (loss) income before income taxes	(9,062,822)	3,382,616	1,333,221
Benefit from (provision for) income taxes	318,291	(1,088,083)	(618,648)
Net (loss) income	$(8,744,531)	$2,294,533	$714,573
Accretion of Trust Account income relating to common stock subject to possible conversion	(92,872)	(235,706)	
Net (loss) income attributable to other common stockholders	$(8,837,403)	$2,058,827	$714,573
Basic and diluted (loss) earnings per share	$(0.39)	$0.08	$0.06
Dividends declared per common share	$0.26	$	$
Basic and diluted weighted average shares outstanding	22,941,728	24,936,558	11,602,789

Results of Operations

The following analysis principally focuses on the results generated in 2009, as our operations did not begin until the completion of the merger transaction in late October 2009. However, the analysis will also include 2008 and 2007 results, where appropriate, which consist of Capitol s operations as a development stage company.

Interest Income and Average Earning Assets Yield

For the three and twelve months ended December 31, 2009, we recognized $2.8 million of interest income from our Agency and non-Agency RMBS portfolio. As of December 31, 2009, our available-for-sale securities portfolio s average days held was approximately 37 days, with our non-Agency higher yielding assets average days held of approximately 34 days. This shortened investment period resulted in an average amortized cost of securities of approximately $181.4 million for the quarter ended December 31, 2009. The annualized net yield on the average amortized cost of our portfolio was approximately 6.2%.

For the three and twelve months ended December 31, 2009, we recognized $1.2 million of net premium amortization on our Agency RMBS, including our interest-only securities. This resulted in an overall net asset

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yield of approximately 4.4% on our Agency RMBS. For the three and twelve months ended December 31, 2009, we recognized $0.6 million of accretion income from the discounts on our non-Agency portfolio resulting in an overall net yield of approximately 16.2%.

The following tables present the components of the net yield earned by investment type on our RMBS portfolio as a percentage of our average amortized cost of securities:

	Three months ended December 31, 2009		
	Agency	Non-Agency	Whole Portfolio
	(Ratios for the quarter have been annualized)		
Gross Yield/Stated Coupon	7.4 %	6.9 %	7.3 %
Net accretion/amortization of discount/premium	(3.0)%	9.3 %	(1.1)%
Net Yield	4.4 %	16.2 %	6.2 %

(1) These yields have not been adjusted for cost of delay and cost to carry purchase premiums.
(2) Prior to October 28, 2009, the Company was a development stage company without operations, therefore, comparative periods are not applicable.

The following table provides the components of interest income and net asset yield detail by investment type on our RMBS portfolio:

	Three months ended December 31, 2009				
	Average Amortized Cost	Coupon Interest	Net (Premium Amortization)/ Discount Accretion	Interest Income	Net Asset Yield
Agency	$ 154,561,598	$ 2,861,123	$ (1,151,080)	$ 1,710,043	4.4 %
Non-Agency	26,874,915	463,470	622,600	1,086,070	16.2 %
Total	$ 181,436,513	$ 3,324,593	$ (528,480)	$ 2,796,113	6.2 %

Our cash and cash equivalents interest income for the twelve months ended December 31, 2009 was principally generated by Capitol prior to the merger transaction, and resulted in annual interest income of $69,940 or approximately 0.00% yield. Subsequent to the merger transaction, our principal cash balances with our primary brokers are held in low yielding overnight money market accounts due to the significant decrease in market interest rates. Additional cash deposits are held in non-interest bearing accounts to support our daily operations. Our overall cash balances are managed relative to our investing, financing and operating requirements, investment opportunities and anticipated market conditions.

Prior to the completion of the merger transaction in 2009 and for the comparative period 2008 and for the period from June 26, 2007 (inception) through December 31, 2007, the Company s principal assets were held in trust and invested in the Merrill Lynch Treasury Fund, an institutional money market mutual fund that invests all of its assets in direct obligations of the U.S. Treasury. Prior to the merger transaction in 2009, the effective annualized interest rate payable on our investment was approximately 0.00%. At December 31, 2008, the effective annualized interest rate payable on our investment was approximately 0.34%.

Interest Expense and the Cost of Funds

For the three and twelve months ended December 31, 2009, we recognized $131,510 in interest expense on our borrowed funds. For the three month period, our average outstanding balance under repurchase agreements was approximately $146.0 million, which was primarily funding our Agency RMBS portfolio. Our leverage ratio of 3.4 times as of December 31, 2009 and low LIBOR rates, resulted in an average cost of funds of 0.4% on an annualized basis.

Net Interest Income

For the three and twelve months ended December 31, 2009, our net interest income on our AFS portfolio was $2.7 million resulting in a net interest spread of approximately 5.8%. The favorable net interest rate spread was largely driven by our low cost of funds due to low LIBOR rates.

The following table provides the interest income and expense incurred in the three months ended December 31, 2009:

	Three months ended December 31, 2009(3)		
	Agency	Non-Agency	Total
	(Percentages for the quarter have been annualized)		
Average Available-for-Sale Securities Held(1)	$154,561,598	$26,874,915	$181,436,513
Total Interest Income	$1,710,043	$1,086,070	$2,796,113
Yield on Average Investment Securities	4.4 %	16.2 %	6.2 %
Average Balance of Repurchase Agreements	$143,678,311	$2,292,556	$145,970,867
Total Interest Expense	$119,833	$11,677	$131,510
Average Cost of Funds(2)	0.3 %	2.0 %	0.4 %
Net Interest Income	$1,590,210	$1,074,393	$2,664,603
Net Interest Rate Spread	4.1 %	14.2 %	5.8 %

(1) Excludes change in realized and unrealized gains/(losses).

(2) Cost of funds by investment type is based off the underlying investment type of the AFS assigned as collateral.

(3) Prior to October 28, 2009, the Company was a development stage company without operations, therefore, comparative periods are not applicable.

Gain on Sale of Investment Securities, Net

For the three and twelve months ended December 31, 2009, we sold AFS securities with a carrying value of $2.5 million for a net gain of $0.3 million. We do not expect to sell assets on a frequent basis, but may sell assets to reallocate capital into new assets that our management believes might have higher risk-adjusted returns.

Each quarter, we review each of our securities to determine if an OTTI charge would be necessary. For the periods ended December 31, 2009, 2008 and 2007, we did not recognize any losses from other-than-temporary impairments.

Unrealized Gain on Interest Rate Swap Agreements

Included in our results was the recognition of a $0.4 million net unrealized gain on our interest rate swap agreement that was accounted as a trading instrument. During the fourth quarter of 2009, we elected to enter into a $100 million notional interest rate swap agreement to hedge a portion of our interest rate risk on our short-term repurchase agreements, effectively establishing a fixed rate of 1.168% over a two year period. The increase in the two-year swap rate at the end of 2009 resulted in the favorable results for the three and twelve months ended December 31, 2009.

Expenses

Management Fees

We incurred management fees of $325,654 for the three and twelve months ended December 31, 2009, which are payable to PRMC Advisers LLC under our management agreement.

Operating Expenses

For the twelve months ended December 31, 2009, we recognized $12.2 million of operating expenses. For the twelve months ended December 31, 2008 and for the period from June 27, 2007 (inception) through December 31, 2007, we recognized $1.1 million and $0.1 million, respectively, of operating expenses.

Our results for 2009 reflect the costs associated with the merger transaction of $9.6 million and costs associated with Capitol as a development stage company prior to the merger transaction of $1.3 million. Excluding these merger transaction and development stage company costs, we incurred operating expenses of

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$1.3 million for the three and twelve months ended December 31, 2009. We believe this non-GAAP financial measure is useful because the excluded costs will not be incurred on a going forward basis. Our results for 2008 and 2007 represent the historical results of Capitol as a development stage company with no operations. The operating expenses for 2008 and 2007 of $1.1 million and $0.1 million, respectively, reflected organizational costs as the development stage company pursued a business combination.

The following table provides operating expenses as a percentage of average equity for the annual and quarterly periods presented:

	Total Operating Expenses	Operating Expenses/Average Equity	
	(Ratios for the quarter have been annualized)		
For the Year Ended December 31, 2009	$ 12,171,343	7.1	%
For the Year Ended December 31, 2008	$ 1,059,606	0.6	%
For the Year Ended December 31, 2007	$ 140,999	0.2	%
For the Quarter Ended December 31, 2009	$ 9,424,934	27.3	%
For the Quarter Ended September 30, 2009	$ 1,040,300	2.3	%
For the Quarter Ended June 30, 2009	$ 1,385,707	3.0	%
For the Quarter Ended March 31, 2009	$ 320,402	0.7	%

(1) Prior to October 28, 2009, the Company was a development stage company without operations.

The following table provides adjusted operating expenses as a percentage of average equity for the three months ended December 31, 2009:

	Three months ended December 31, 2009	Operating Expenses/Average Equity	
	(Ratios for the quarter have been annualized)		
Total operating expenses	$9,424,934	27.3	%
Less: Costs associated with business combination	(7,965,784)	-23.1	%
Less: Costs associated with Capitol as a development stage company	(206,798)	-0.6	%
Adjusted total operating expenses	$ 1,252,352	3.6	%

(1) Prior to October 28, 2009, the Company was a development stage company without operations.

Our adjusted operating expenses as a percentage of average equity for the three months ended December 31, 2009 was 3.6%. We believe this non-GAAP financial measure is useful because the excluded costs will not be incurred on a going forward basis. We expect an annualized expense ratio ranging from 2.8% to 3.2% in 2010 based on our current business model and equity base.

Income Taxes

For the twelve months ended December 31, 2009, we recognized current federal tax benefits of $0.4 million resulting from the available-carry-back of net losses of $1.3 million of our TRS. Offsetting the current federal tax benefits, we have recognized $0.1 million of deferred tax expense related to the unrealized income on our interest rate swap agreement held in our TRS. We currently intend to distribute 100% of our REIT taxable income, and therefore we have not recognized any further federal or state tax provisions. Our resulting effective tax rate was approximately negative 4%.

For the twelve months ended December 31, 2008 and for the period from June 26, 2007 (inception) through December 31, 2007, we recognized federal tax provisions of $1.1 million and $0.6 million with effective tax rates of 32% and 46%, respectively. The 2007 federal tax rate was higher due to additional federal tax due to personal holding company status.

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Financial Condition

Available-for-Sale Securities, at Fair Value

Agency RMBS

Our Agency RMBS portfolio is comprised of adjustable rate and fixed rate mortgage-backed securities backed by single-family and multi-family mortgage loans. All of our Agency RMBS were Fannie Mae or Freddie Mac mortgage pass-through certificates or collateralized mortgage obligations that carry an implied AAA rating, or Ginnie Mae mortgage pass-through certificates, which are backed by the guarantee of the U.S. Government. The majority of these securities consist of whole pools in which we own all of the investment interests in the securities.

The table below summarizes certain characteristics of our Agency available-for-sale securities at December 31, 2009:

	Principal/ Current Face	Net Discount/ Premium	Amortized Cost	Unrealized Gain	Unrealized Loss	Carrying Value	Weighted Average Coupon Rate	Weighted Average Purchase Price
Principal and interest securities								
Fixed	$93,760,620	$4,258,506	$98,019,126	$	$(1,690,695)	$96,328,431	5.23%	$104.62
Hybrid/ARM	292,332,359	14,276,600	306,608,959	119,611	(1,287,300)	305,441,270	4.37%	$104.92
Total P&I Securities	$386,092,979	$18,535,106	$404,628,085	$119,611	$(2,977,995)	$401,769,701	4.58%	$104.85
Interest-only securities								
Fixed	148,785,878	(133,343,316)	15,442,562	962,336	(354,583)	16,050,315	5.51%	$10.76
Total	$534,878,857	$(114,808,210)	$420,070,647	$1,081,947	$(3,332,578)	$417,820,016		

Our three-month average prepayment rate, or CPR, experienced during the fourth quarter of 2009 by Agency RMBS owned by us as of December 31, 2009, on an annualized basis, was 12.0%.

The following table summarizes months to re-set characteristics for our floating or adjustable rate Agency RMBS mortgage portfolio at December 31, 2009:

	Carrying Value
0 12 months	$116,667,705
13 36 months	147,814,171
37 60 months	5,538,964
Greater than 60 months	35,420,430
Total	$305,441,270

Non-Agency RMBS

Our non-Agency RMBS portfolio is comprised of senior and mezzanine tranches of mortgage-backed securities. The following table provides investment information on our non-Agency RMBS as of December 31, 2009:

	Principal/ Current Face	Accretable Purchase Discount	Credit Reserve Purchase Discount	Amortized Cost	Unrealized Gain	Unrealized Loss	Carrying Value
Senior	$110,687,783	$(34,420,207)	$(22,709,996)	$53,557,580	$1,007,365	$(473,316)	$54,091,629
Mezzanine	55,892,526	(6,629,531)	(27,476,627)	21,786,368	1,012,973	(246,119)	22,553,222
Total	$166,580,309	$(41,049,738)	$(50,186,623)	$75,343,948	$2,020,338	$(719,435)	$76,644,851

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The following tables present certain information detailed by investment type and their respective underlying loan characteristics for our senior and mezzanine non-Agency RMBS, excluding our non-Agency interest-only portfolio, at December 31, 2009:

	Non-Agency RMBS Characteristics					
	Senior Bonds		Mezzanine Bonds		Total Bonds	
Carrying Value	$53,646,122		$22,553,222		$76,199,343	
% of Non-Agency Portfolio	70.4	%	29.6	%	100.0	%
Average Price	$55.19		$40.35		$49.77	
Average Coupon	3.6	%	2.8	%	3.3	%
Average Fixed Coupon	5.6	%	5.8	%	5.6	%
Average Floating Coupon	1.0	%	1.0	%	1.0	%
Average Hybrid Coupon	5.5	%	5.6	%	5.6	%
Collateral Attributes						
Avg Loan Age (months)	50		57		52	
Avg Original Loan-to-Value	75	%	70	%	73	%
Avg Original FICO[1]	689		722		699	
Current Performance						
60+ day delinquencies	26	%	16	%	23	%
Average credit enhancement[2]	13.1	%	11.7	%	12.7	%
3-Month CPR[3]	13.9	%	18.0	%	15.1	%

(1) Fair Isaac Corporation, or FICO represents a mortgage industry accepted credit score of a borrower.

(2) Average credit enhancement remaining on our non-Agency RMBS portfolio, which is the average amount of protection available to absorb future credit losses due to defaults on the underlying collateral.

(3) 3-Month CPR is reflective of the prepayment speed on the underlying securitization; however, it does not necessarily indicate the proceeds received on our investment tranche. Proceeds received for each security are dependent on the position of the individual security within the structure of each deal.

	Non-Agency RMBS Characteristics					
	Senior Bonds		Mezzanine Bonds		Total	
Loan Type	Carrying Value	% of Senior Bonds	Carrying Value	% of Mezzanine Bonds	Carrying Value	% of Non-Agency Portfolio
Prime	$ 8,607,542	16.0 %	$ 10,247,880	45.4 %	$ 18,855,421	24.7 %
Alt-A	28,153,545	52.5 %	6,123,310	27.2 %	34,276,855	45.0 %
POA	4,838,051	9.0 %	6,182,032	27.4 %	11,020,083	14.5 %
Subprime	12,046,984	22.5 %		0.0 %	12,046,984	15.8 %
	$ 53,646,122	100 %	$ 22,553,222	100 %	$ 76,199,343	100.0 %

	Non-Agency RMBS Characteristics		
	Senior Bonds	Mezzanine Bonds	Total
Coupon Type			

	Carrying Value	% of Senior Bonds	Carrying Value	% of Mezzanine Bonds	Carrying Value	% of Non-Agency Portfolio
Fixed Rate	$ 33,493,920	62.4 %	$ 7,856,665	34.8 %	$ 41,350,585	54.3 %
Hybrid or Floating	20,152,202	37.6 %	14,696,557	65.2 %	34,848,758	45.7 %
	$ 53,646,122	100 %	$ 22,553,222	100 %	$ 76,199,343	100.0 %

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	Non-Agency RMBS Characteristics					
	Senior Bonds		Mezzanine Bonds		Total	
Loan Origination Year	Carrying Value	% of Senior Bonds	Carrying Value	% of Mezzanine Bonds	Carrying Value	% of Non-Agency Portfolio
2006+	$ 24,019,583	44.8 %	$ 5,086,539	22.6 %	$ 29,106,122	38.2 %
2002 2005	29,048,277	54.1 %	17,262,225	76.5 %	46,310,501	60.8 %
pre-2002	578,262	1.1 %	204,458	0.9 %	782,720	1.0 %
	$ 53,646,122	100 %	$ 22,553,222	100 %	$ 76,199,343	100.0 %

The underlying mortgage loans collateralizing our non-Agency RMBS are located across the United States. The following table presents the five largest geographic concentrations of the mortgages collateralizing these RMBS at December 31, 2009:

	Carrying Value	% of non-Agency RMBS
California	$ 28,860,972	37.7 %
Florida	7,589,284	9.9 %
New York	4,006,864	5.2 %
Texas	2,681,031	3.5 %
Arizona	2,555,560	3.3 %
	$ 45,693,711	59.6 %

Repurchase Agreements

Our borrowings consist entirely of repurchase agreements collateralized by our pledge of AFS securities and certain cash balances. All of our Agency RMBS are currently pledged as collateral, however, only a portion of our non-Agency RMBS has been pledged, and as of December 31, 2009 our leverage ratio (i.e., our debt to equity ratio) was 3.4:1.0. We believe our leverage ratio provides unused borrowing capacity and thus improves our liquidity and the strength of our balance sheet.

For the year ended December 31, 2009, the term to maturity of our borrowings ranged from seven days to over five months. The weighted average original term to maturity of our borrowings was 90 days at December 31, 2009. At December 31, 2009, the weighted average cost of funds for all our repurchase agreements was 0.4%.

Equity

As of December 31, 2009, our stockholders equity was $121.7 million and our diluted book value per share was $9.08. As of December 31, 2008, our stockholders equity was $184.2 million. The large decrease was principally due to the conversion of shares to cash and the repurchase of shares by Capitol as part of the merger transaction completed on October 28, 2009. Immediately thereafter, we estimated our stockholders equity to be $124.6 million and our book value per share to be $9.30. The subsequent reduction in book value is principally driven by net income during the period from the date of merger to December 31, 2009 of approximately $1.7 million, the declaration of dividends of $3.5 million representing our taxable income and unrealized losses in accumulated other comprehensive income of $1.0 million. Taxable net income in the REIT was higher than GAAP net income by approximately $5.5 million due to non-deductible merger transaction expenses in the REIT of $3.3 million, higher net accretion of discount to taxable interest income $1.2 million, and the stock conversion proceeds from the merger transaction being treated as dividends of earnings from Capitol to us of $1.0 million.

The following table provides details of our changes in stockholders equity from the date of the merger transaction through December 31, 2009:

(dollars in thousands, except per share amounts)	Book Value	Book Value per Share (diluted basis)
Stockholders equity at merger completion	$ 124,634	$ 9.30
Post-merger activities		
GAAP net income, net of tax	1,676	0.13
Other comprehensive income	(950)	(0.07)
Dividend declaration	(3,484)	(0.26)
Other	(155)	(0.02)
Stockholders equity at December 31, 2009	$ 121,721	$ 9.08

GAAP to Taxable Income

The following table provides reconciliation of our GAAP loss to our taxable income (loss) split between our REIT and TRS for the year ended December 31, 2009:

(dollars in millions)	TRS	REIT	Consolidated
GAAP net loss, pre-tax	$ (7.2)	$ (1.9)	$ (9.1)
Permanent differences			
Capitol dividend of E&P		1.0	1.0
Non-deductible business combination expenses	6.3	3.3	9.6
Temporary differences			
Net accretion of OID and market discount		1.2	1.2
Unrealized gain on interest rate swap agreement	(0.4)		(0.4)
Taxable (loss) income	$ (1.3)	$ 3.6	$ 2.3
Dividend declaration deduction		(3.5)	(3.5)
Taxable (loss) income post-dividend deduction	$ (1.3)	$ 0.1	$ (1.2)

The permanent tax differences are non-recurring permanent tax differences that were recorded in 2009. These items will not impact future dividend declarations and/or book value in 2010 and beyond. Temporary differences are principally timing differences between GAAP and tax accounting, which will adjust over the course of the RMBS s term and/or at time of sale of the RMBS in the future.

Change in Accumulated Other Comprehensive Income

With our accounting treatment for AFS, unrealized fluctuations in the market values of securities do not impact our GAAP or taxable income but are recognized on our balance sheet as a change in stockholders equity under accumulated other comprehensive income/(loss). As a result of this fair value accounting through stockholders equity, we expect our net income to have less significant fluctuations and result in less GAAP to taxable income timing differences, than if the portfolio were accounted as trading instruments.

Dividends

On December 21, 2009, we declared a quarterly dividend of $0.26 per share of common stock for the fourth quarter of 2009, our first dividend since becoming an operating company on October 28, 2009. As a REIT, we are required to distribute 90% of our taxable income to stockholders, subject to certain distribution requirements. Our board of directors for the fiscal year ended 2009 has elected to distribute the majority of our taxable income to avoid U.S. Federal Income taxes. As such, temporary differences between GAAP and taxable income can generate deterioration in book value on a permanent and temporary basis as taxable income is distributed that has not been earned for GAAP purposes.

Liquidity and Capital Resources

Our liquidity and capital resources are managed and forecast on a daily basis to principally ensure that we have sufficient liquidity to absorb market events that could negatively impact collateral valuations and result in margin calls and the flexibility to proactively manage our portfolio to take advantage of market opportunities.

Upon completion of this offering, our principal sources of cash will consist of borrowings under repurchase agreements, payments of principal and interest we receive on our RMBS portfolio, cash generated from our operating results, the net proceeds of this offering, and, depending on future market conditions, proceeds from capital market transactions. We typically use cash to repay principal and interest on our repurchase agreements, to purchase RMBS, to make dividend payments on our capital stock, and to fund our operations.

To the extent that we raise additional equity capital through other capital market transactions, we anticipate using cash proceeds from such transactions to purchase additional RMBS and for other general corporate purposes. There can be no assurance, however, that we will be able to raise additional equity capital at any particular time or on any particular terms. Credit Suisse Securities (USA) LLC and the underwriters in Capitol s initial public offering have certain rights to participate in any future securities offerings by us.

As of December 31, 2009, we held $26.1 million in cash and cash equivalents available to support our operations, $494.5 million of AFS held at fair value and $411.9 million of outstanding debt in the form of repurchase agreements. As of December 31, 2009, our debt-to-equity ratio was 3.4:1.0. As of December 31, 2009, we had approximately $49.6 million of pledged non-Agency securities and an overall estimated unused borrowing capacity of approximately $29.8 million. If borrowing rates and collateral requirements change in 2010, we are positioned to adjust to higher interest rates with less earnings volatility than a more leveraged organization.

Our ongoing sources of financing are expected to be through repurchase agreements. We plan to finance our assets with a moderate amount of leverage, the level of which may vary based upon the particular characteristics of our portfolio and on market conditions. We may deploy, on a debt-to-equity basis, up to ten times leverage on our Agency RMBS assets. We also deploy some leverage on our non-Agency RMBS assets utilizing repurchase agreements as the source of financing. Also, we may increase our use of leverage for non-Agency RMBS in conjunction with financings that may be available under programs established by the U.S. Government. However, as of the date hereof, the government has suspended its former plans to expand the TALF to include RMBS and the PPIP Legacy Loans Program is not available to us at this time.

Under our repurchase agreements, we are required to pledge additional assets as collateral to our repurchase agreement counterparties (lenders) when the estimated fair value of the existing pledged collateral under such agreements declines and such lenders, through a margin call, demand additional collateral. Lenders generally make margin calls because of a perceived decline in the value of our assets collateralizing the repurchase agreements. This may occur following the monthly principal reduction of assets due to scheduled amortization and prepayments on the underlying mortgages, or may be caused by changes in market interest rates, a perceived decline in the market value of the investments and other market factors. To cover a margin call, we may pledge additional securities or cash. At maturity, any cash on deposit as collateral is generally applied against the repurchase agreement balance, thereby reducing the amount borrowed. Should the value of our assets suddenly decrease, significant margin calls on our repurchase agreements could result, causing an adverse change in our liquidity position.

The following table summarizes assets at carrying value that are pledged or restricted as collateral for the future payment obligations of repurchase agreements.

	December 31, 2009	December 31, 2008
AFS Securities	$ 444,833,063	$
Restricted Cash	913,048	
Due from counterparties	1,736,952	
Total	$ 447,483,063	$

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While we generally intend to hold our target assets as long-term investments, we may sell certain of our investment securities in order to manage our interest rate risk and liquidity needs, meet other operating objectives and adapt to market conditions. We cannot predict the timing and impact of future sales of investment securities, if any. Because many of our investment securities are generally financed with repurchase agreements, and may be financed with credit facilities (including term loans and revolving facilities) and borrowings under programs established by the U.S. Government, a significant portion of the proceeds from sales of our investment securities (if any), prepayments and scheduled amortization are used to repay balances under these financing sources.

The following table provides the maturities of our repurchase agreements as of December 31, 2009.

	December 31, 2009
Within 30 days	$ 207,050,239
30 to 59 days	
60 to 89 days	
90 to 119 days	
Over 120 days	204,842,271
Total	$ 411,892,510

For the twelve-months ended December 31, 2009, our unrestricted cash balance increased from $2.8 million to $26.1 million. The cash movements can be summarized by the following:

Cash flows from operating activities. For the twelve months ended December 31, 2009, operating activities reduced our cash balances by approximately $16.2 million. The primary driver of this reduction was $10.9 million of operating expenses incurred as part of the merger transaction and associated activities of Capitol as a development stage company. Unlike an initial public offering, the costs of approximately $9.6 million associated with the merger transaction were recorded in the income statement and reflected as an operating activity of Capitol because the Company s existence was for the purposes of completing a business combination or similar transaction.
Cash flows from investing activities. For the twelve months ended December 31, 2009, investing activities reduced our cash balances by approximately $245.3 million. The reduction was driven by the purchase of our RMBS portfolio in the last quarter of 2009.
Cash flows from financing activities. For the twelve months ended December 31, 2009, financing activities increased our cash balance by approximately $284.9 million resulting from the net borrowings under repurchase agreements to fund a portion of our RMBS portfolio, which was offset by payments to Capitol stockholders who did not participate in the business combination.

Off-Balance Sheet Arrangements

We have no obligations, assets or liabilities which would be considered off-balance sheet arrangements. We do not participate in transactions that create relationships with unconsolidated entities or financial partnerships, often referred to as variable interest entities, which would have been established for the purpose of facilitating off-balance sheet arrangements.

Aggregate Contractual Obligations

As of December 31, 2009, we do not have any long-term debt, capital lease obligations, operating lease obligations or long-term liabilities.

Subsequent to the merger transaction, we have established a number of master repurchase agreements with counterparties and we expect to execute additional master repurchase agreements. These repurchase agreements are short-term with maturities of less than one year.

We have entered into a management agreement with PRCM Advisers LLC, pursuant to which PRCM Advisers LLC is entitled to receive a management fee and the reimbursement of certain expenses from us. We reimburse PRCM Advisers LLC for (i) in the event PRCM Advisers LLC were to hire its own personnel, our allocable share of the compensation paid by PRCM Advisers LLC to its personnel serving as our principal

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financial officer and general counsel and personnel employed by PRCM Advisers LLC as in-house legal, tax, accounting, consulting, auditing, administrative, information technology, valuation, computer programming and development and back-office resources to us, and (ii) any amounts for personnel of PRCM Advisers LLC s affiliates arising under a shared facilities and services agreement.

We are party to contracts that contain a variety of indemnification obligations, principally with brokers, underwriters and counterparties to repurchase agreements. The maximum potential future payment amount we could be required to pay under these indemnification obligations may be unlimited.

Recently Issued Accounting Standards

Refer to Note 2 of the Notes to the Consolidated Financial Statements included elsewhere in this prospectus.

Inflation

Substantially all of our assets and liabilities are financial in nature. As a result, changes in interest rates and other factors impact our performance far more than does inflation. Our financial statements are prepared in accordance with GAAP and dividends are based upon net ordinary income as calculated for tax purposes; in each case, our results of operations and reported assets, liabilities and equity are measured with reference to historical cost or fair value without considering inflation.

Other Matters

We intend to conduct our business so as to maintain our exempt status under, and not to become regulated as an investment company for purposes of the 1940 Act. If we failed to maintain our exempt status under the 1940 Act and became regulated as an investment company, our ability to, among other things, use leverage would be substantially reduced and, as a result, we would be unable to conduct our business as described in *Business Our Business Regulation*. Accordingly, we monitor our compliance with both the 55% Test and the 80% Tests of the 1940 Act in order to maintain our exempt status. As of December 31, 2009, we determined that we were in compliance with both the 55% Test and the 80% Test requirements.

We calculate that at least 75% of our assets were qualified REIT assets, as defined in the Code for the period ended December 31, 2009. We also calculate that our revenue qualifies for the 75% source of income test and for the 95% source of income test rules for the period ended December 31, 2009. Consequently, we met the REIT income and asset tests. We also met all REIT requirements regarding the ownership of our common stock and the distribution of our net income. Therefore, for the period ended December 31, 2009, we believe that we qualified as a REIT under the Code.

Quantitative and Qualitative Disclosures about Market Risk

We seek to manage our risks related to the credit quality of our assets, interest rates, liquidity, prepayment speeds and market value while seeking to provide an opportunity to stockholders to realize attractive risk-adjusted returns through ownership of our capital stock. Although we do not seek to avoid risk completely, we believe that risk can be quantified from historical experience and we seek to actively manage our risk levels in order to earn sufficient compensation to justify the risks we undertake and to maintain capital levels consistent with taking such risks.

To reduce the risks to our portfolio, we employ portfolio-wide and security-specific risk measurement and management processes in our daily operations. PRCM Advisers LLC s risk management tools include software and services licensed or purchased from third parties, in addition to proprietary software and analytical methods developed by Pine River. There can be no guarantee that these tools will protect us from market risks.

Interest Rate Risk

Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political considerations, as well as other factors beyond our control. We are subject to interest rate risk in connection with our assets and related financing obligations. Subject to maintaining our qualification as a REIT, we engage in a variety of interest rate management techniques that seek to mitigate the influence of interest rate changes on the values of our assets.

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We utilize interest-only securities as well as derivative financial instruments, currently limited to interest rate swaps as of December 31, 2009, to hedge the interest rate risk associated with our portfolio. We seek to hedge interest rate risk with respect to both the fixed income nature of our assets and the financing of our portfolio. In hedging interest rates with respect to our fixed income assets, we seek to reduce the risk of losses on the value of our investments that may result from changes in interest rates in the broader markets. In utilizing interest rate hedges with respect to our financing, we seek to improve risk-adjusted returns and, where possible, to obtain a favorable spread between the yield on our assets and the cost of our financing. We rely on PRCM Advisers LLC s expertise to manage these risks on our behalf. We implement part of our hedging strategy through Capitol, our TRS, which is subject to U.S. federal, state and, if applicable, local income tax.

Interest Rate Effect on Net Interest Income

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

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

We acquire adjustable-rate and hybrid RMBS. These are assets in which the underlying mortgages are typically subject to periodic and lifetime interest rate caps and floors, which limit the amount by which the security s interest yield may change during any given period. However, our borrowing costs pursuant to our financing agreements are not subject to similar restrictions. Therefore, in a period of increasing interest rates, interest rate costs on our borrowings could increase without limitation, while the interest-rate yields on our adjustable-rate and hybrid RMBS would effectively be limited by caps. This issue will be magnified to the extent we acquire adjustable-rate and hybrid RMBS that are not based on mortgages that are fully indexed. In addition, adjustable-rate and hybrid RMBS may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. If this happens, we could receive less cash income on such assets than we would need to pay for interest costs on our related borrowings. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would harm our financial condition, cash flows and results of operations.

Interest Rate Mismatch Risk

We fund the majority of our adjustable-rate and hybrid Agency RMBS assets with borrowings that are based on LIBOR, while the interest rates on these assets may be indexed to other index rates, such as the one-year Constant Maturity Treasury index, or CMT, the Monthly Treasury Average index, or MTA, or the 11th District Cost of Funds Index, or COFI. Accordingly, any increase in LIBOR relative to these indices may result in an increase in our borrowing costs that is not matched by a corresponding increase in the interest earnings on these assets. Any such interest rate index mismatch could adversely affect our profitability, which may negatively impact distributions to our stockholders. To mitigate interest rate mismatches, we utilize the hedging strategies discussed above.

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The following table provides the indices of our variable rate assets as of December 31, 2009, based on total notional amount of bonds.

Index Type	Floating	Hybrid*	Total	Index Percentage
CMT	$ 107,667,722	$ 124,833,299	$ 232,501,021	62 %
LIBOR	74,452,692	40,014,206	114,466,898	31 %
Other**	6,521,548	18,385,162	24,906,710	7 %
Total	$ 188,641,962	$ 183,232,667	$ 371,874,629	100 %

* Hybrid amounts reflect those assets with greater than 12 months to reset.

** Other-includes COFI, MTA and other indices.

Our analysis of risks is based on PRCM Advisers LLC and its affiliates experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of decisions by PRCM Advisers LLC may produce results that differ significantly from the estimates and assumptions used in our models.

We use a variety of recognized industry models, as well as proprietary models, to perform sensitivity analyses which are derived from primary assumptions for prepayment rates, discount rates and credit losses. The primary assumption used in this model is implied market volatility of interest rates. The information presented in the following interest sensitivity table projects the potential impact of sudden parallel changes in interest rates on our financial results and financial condition, over the next 12 months based on our interest sensitive financial instruments at December 31, 2009.

All changes in value are measured as the change from the December 31, 2009 financial position. All projected changes in annualized net interest income are measured as the change from the projected annualized net interest income based off current performance returns.

Interest Rate Sensitivity Table

	-100 bps	-50 bps	+50 bps	+100 bps
Change in value of financial position:				
AFS securities, at fair value	$ 1,471,044	$ 1,427,092	$ (2,493,242)	$ (5,677,702)
As a % of December 31, 2009 equity	*1.2%*	*1.2%*	*-2.0%*	*-4.7%*
Derivative Assets	$ (1,790,000)	$ (903,000)	$ 728,000	$ 1,444,000
As a % of December 31, 2009 equity	*-1.5%*	*-0.7%*	*0.6%*	*1.2%*
Repurchase Agreements	$ (404,966)	$ (404,966)	$ 512,553	$ 1,025,106
As a % of December 31, 2009 equity	*-0.3%*	*-0.3%*	*0.4%*	*0.8%*
Total Net Assets	$ (723,922)	$ 119,126	$ (1,252,689)	$ (3,208,596)
As a % of December 31, 2009 equity	*-0.6%*	*0.1%*	*-1.0%*	*-2.6%*
	-100 bps	-50 bps	+50 bps	+100 bps
Change in annualized net interest income:	$ 515,747	$ 257,873	(768,181)	$ (1,536,363)
% change in net interest income	*2%*	*1%*	*-4%*	*-7%*

The AFS securities, at fair value, included in the interest rate sensitivity table change in value of financial position were limited to Agency RMBS. Due to our non-Agency RMBS s significantly discounted prices and underlying credit risks, we believe our non-Agency RMBS s valuation is inherently de-sensitized to changes in interest rates. As such, we cannot project the impact to these financial instruments and excluded these RMBS from the interest rate sensitivity analysis. These non-Agency RMBS have been included in the change in annualized net interest income analysis.

Certain assumptions have been made in connection with the calculation of the information set forth in the foregoing interest rate sensitivity table and, as such, there can be no assurance that assumed events will occur or that other events will not occur that would affect the outcomes. The base interest rate scenario assumes interest rates at December 31, 2009. The analysis presented utilizes assumptions and estimates based on management s judgment and experience. Furthermore, while we generally expect to retain such assets and the associated interest rate risk to maturity, future purchases and sales of assets could materially change our interest rate risk profile. It should be specifically noted that the information set forth in the interest rate sensitivity table and all related disclosure constitutes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act. Actual results could differ significantly from those estimated in the foregoing interest rate sensitivity table.

The interest rate sensitivity table quantifies the potential changes in net interest income and portfolio value, which includes the value of swaps, should interest rates immediately change. The interest rate sensitivity table presents the estimated impact of interest rates instantaneously rising 50 and 100 basis points, and falling 50 and 100 basis points. The cash flows associated with the portfolio of RMBS for each rate change are calculated based on assumptions, including prepayment speeds, yield on future acquisitions, slope of the yield curve and size of the portfolio. Assumptions made on the interest rate sensitive liabilities, which are assumed to relate to repurchase agreements, include anticipated interest rates, collateral requirements as a percent of the repurchase agreement, amount and term of borrowing.

The change in annualized net interest income does not include any benefit or detriment from faster or slower prepayment rates on our Agency premium bonds, non-Agency discount bonds, and instruments that represent the interest payments (but not the principal) on a pool of mortgages, or Interest-Only bonds. We anticipate that faster prepayment speeds in lower interest rate scenarios will generate lower realized yields on Agency premium and Interest-Only bonds and higher realized yields on non-Agency discount bonds. Similarly, we anticipate that slower prepayment speeds in higher interest rate scenarios will generate higher realized yields on Agency premium and Interest-Only bonds and lower realized yields on non-Agency discount bonds. Although we have sought to construct the portfolio to limit the effect of changes in prepayment speeds, there can be no assurance this will actually occur, and the realized yield of the portfolio may be significantly different than we anticipate in changing interest rate scenarios.

Given the low interest rates at December 31, 2009, we applied a floor of 0% for all anticipated interest rates included in our assumptions. Because of this floor, we anticipate that any hypothetical interest rate shock decrease would have a limited positive impact on our funding costs; however, because prepayments speeds are unaffected by this floor, we expect that any increase in our prepayment speeds (occurring as a result of any interest rate decrease or otherwise) could result in an acceleration of our premium amortization on Agency and Interest-Only bonds purchased at a premium, and accretion of discount on our non-Agency bonds purchased at a discount. As a result, because this floor limits the positive impact of any interest rate decrease on our funding costs, hypothetical interest rate decreases could cause the fair value of our financial instruments and our net interest income to decline.

Prepayment Risk

Prepayment risk is the risk that principal will be repaid at a different rate than anticipated. As we receive prepayments of principal on our assets, premiums paid on such assets will be amortized against interest income. In general, an increase in prepayment rates will accelerate the amortization of purchase premiums, thereby reducing the interest income earned on the assets. Conversely, discounts on such assets are accreted into interest income. In general, an increase in prepayment rates will accelerate the accretion of purchase discounts, thereby increasing the interest income earned on the assets.

Market Risk

Market Value Risk. Our AFS securities are reflected at their estimated fair value, with the difference between amortized cost and estimated fair value reflected in accumulated other comprehensive income. The estimated fair value of these securities fluctuates primarily due to changes in interest rates and other factors. Generally, in a rising interest rate environment, we would expect the fair value of these securities to decrease; conversely, in a decreasing interest rate environment, we would expect the fair value of these securities to increase. As market volatility increases or liquidity decreases, the fair value of our assets may be adversely impacted.

Real estate risk. Residential RMBS and residential property values are subject to volatility and may be affected adversely by a number of factors, including national, regional and local economic conditions; local real estate conditions (such as an oversupply of housing); changes or continued weakness in specific industry segments; construction quality, age and design; demographic factors; and retroactive changes to building or similar codes. Decreases in property values reduce the value of the collateral for a mortgage loan and the potential proceeds available to a borrower to repay the loan, which could also cause us to suffer losses.

Credit Risk

We believe that our investment strategy will generally keep our risk to credit losses low to moderate. However, we retain the risk of potential credit losses on all of the loans underlying our non-Agency RMBS. With respect to our non-Agency RMBS that are senior in the credit structure, credit support contained in RMBS deal structures provide a level of protection from losses. We seek to manage the remaining credit risk through our pre-acquisition due diligence process, and by factoring assumed credit losses into the purchase prices we pay for non-Agency RMBS. In addition, with respect to any particular target asset, PRCM Advisers LLC s investment team evaluates relative valuation, supply and demand trends, shape of yield curves, prepayment rates, delinquency and default rates, recovery of various sectors and vintage of collateral. Nevertheless, unanticipated credit losses could adversely affect our operating results.

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BUSINESS

Overview

We are a Maryland corporation focused on investing in, financing and managing residential mortgage-backed securities, or RMBS, and related investments. We intend to qualify as a real estate investment trust, or REIT, as defined under the Internal Revenue Code of 1986, as amended, or the Code.

We are externally managed by PRCM Advisers LLC. PRCM Advisers LLC is a wholly-owned subsidiary of our sponsor, Pine River Capital Management L.P., which we refer to as Pine River, a global multi-strategy asset management firm with an established track record of investing in our target assets and fixed income securities.

Our objective is to provide attractive risk-adjusted returns to our investors over the long term, primarily through dividends and secondarily through capital appreciation. We selectively acquire and manage an investment portfolio of our target assets, which is constructed to generate attractive returns through market cycles. We focus on security selection and implement a relative value investment approach across various sectors within the residential mortgage market. Our target assets include the following:

Agency RMBS, meaning RMBS whose principal and interest payments are guaranteed by the Government National Mortgage Association (or Ginnie Mae), the Federal National Mortgage Association (or Fannie Mae), or the Federal Home Loan Mortgage Corporation (or Freddie Mac).

Non-Agency RMBS, meaning RMBS that are not issued or guaranteed by Ginnie Mae, Fannie Mae or Freddie Mac, and

Financial assets other than RMBS, comprising approximately 5% to 10% of the portfolio.

We seek to deploy moderate leverage as part of our investment strategy. We generally finance our target assets through short-term borrowings structured as repurchase agreements. We may also finance portions of our portfolio through non-recourse term borrowing facilities and equity financing provided by government programs, if such financing becomes available.

We recognize that investing in our target assets is competitive and that we compete with other investment vehicles for attractive investment opportunities. We rely on our management team and Pine River, who have developed strong relationships with a diverse group of financial intermediaries. In addition, we have benefited and expect to continue to benefit from Pine River s analytical and portfolio management expertise and infrastructure. We believe that our significant focus on the RMBS area, the extensive RMBS expertise of our investment team, our strong analytics and our disciplined relative value investment approach give us a competitive advantage versus our peers.

We intend to elect and qualify to be taxed as a REIT for U.S. federal income tax purposes, commencing with our initial taxable period ended December 31, 2009. To qualify as a REIT we will be required to meet certain investment and operating tests and annual distribution requirements. We generally will not be subject to U.S. federal income taxes on our taxable income to the extent that we annually distribute all of our net taxable income to stockholders and maintain our intended qualification as a REIT. However, certain activities that we may perform may cause us to earn income which will not be qualifying income for REIT purposes. We have preserved Capitol as a taxable REIT subsidiary, or TRS, as defined in the Code, to engage in such activities, and we may in the future form additional TRS s. We also intend to operate our business in a manner that will permit us to maintain our exemption from registration under the Investment Company Act of 1940, as amended, or the 1940 Act.

Capitol Acquisition Corp. (prior to October 28, 2009)

Capitol was a blank check company formed under the laws of the State of Delaware on June 26, 2007 to effect a merger, capital stock exchange, asset acquisition, stock purchase, reorganization or similar business combination with one or more businesses or assets.

On November 14, 2007, Capitol completed its initial public offering of 25,000,000 units at a price of $10.00 per unit, and received net proceeds of approximately $239.8 million. Capitol received additional net proceeds of $12.0 million on December 12, 2007, as a result of the initial public offering underwriters exercising their over-allotment option to purchase an additional 1,249,000 units. Each unit consisted of one share of Capitol s common stock and one redeemable common stock purchase warrant. Each warrant entitled the holder to purchase from Capitol one share of common stock at an exercise price of $7.50, commencing the later of the completion of a business combination or November 8, 2008 and expiring November 8, 2012. Certain of Capitol s sponsors and founding stockholders, or the Initial Stockholders, purchased an additional 7,000,000 warrants for $7.0 million. The purchase and issuance of these warrants occurred simultaneously with consummation of the IPO on a private placement basis. All of the net proceeds received from the foregoing sale of securities, totaling approximately $258.4 million, were placed in a trust account pursuant to Capitol s charter, pending consummation of a business combination.

On June 11, 2009, Capitol signed an Agreement and Plan of Merger with Two Harbors, Two Harbors Merger Corp. and Pine River which sets forth the terms and conditions whereby Capitol agreed to merge into Two Harbors Merger Corp., with Capitol being the surviving entity and becoming a wholly-owned subsidiary of Two Harbors.

Consummation of the Merger Transaction

On October 26, 2009, the majority of Capitol s stockholders approved the merger transaction, and the transaction closed on October 28, 2009. In connection with the closing, the holders of Capitol s common stock and warrants became holders of the securities of Two Harbors after the merger in the same proportion as their holdings in Capitol immediately before the merger, except as (i) increased by (A) the cancellation of 6,562,257 shares of Capitol common stock held by the Initial Stockholders, (B) conversion of 6,875,130 shares of Capitol common stock by holders thereof who exercised the right to have their shares converted into funds held in the trust account at a value of $9.87 per share and (C) the purchase of 5,994,661 shares pursuant to forward sales agreements that provided for Capitol to purchase such shares after the closing of the merger at a price of $9.87 per share and (ii) decreased by the issuance of 22,159 shares of restricted stock to our independent directors at the closing.

In addition, in connection with the closing of the merger transaction, we entered into a supplement and amendment to the agreement that governs the warrants, the terms of which, among other things, (i) increased the exercise price of the warrants from $7.50 per share to $11.00 per share, (ii) extended the expiration date of the warrants from November 7, 2012 to November 7, 2013 and (iii) limited a holder s ability to exercise warrants to ensure that such holder s Beneficial Ownership or Constructive Ownership (each as defined in our charter) do not exceed the restrictions contained in the charter limiting the ownership of shares of our common stock.

Two Harbors Investment Corp. (post-merger)

As of October 28, 2009, upon consummation of the merger agreement, we commenced doing business as Two Harbors Investment Corp. Our common stock and warrants are listed on the NYSE Amex under the symbols TWO and TWO.WS, respectively.

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The following chart shows our structure. We conduct substantially all of our operations through our wholly-owned subsidiary, Two Harbors Operating Company LLC, or the Subsidiary LLC. The Subsidiary LLC in turn conducts its business through two subsidiaries: Two Harbors Asset I, LLC, which holds most of our RMBS and other assets; and Capitol, which we have elected to treat as a TRS, and which holds certain non-RMBS assets and conducts certain economic hedging activity.

Our Business

Investment Guidelines and Strategy

Our board of directors has adopted the following investment guidelines:

- no investment shall be made that would cause us to fail to qualify as a REIT for U.S. federal income tax purposes;
- no investment shall be made that would cause us to be regulated as an investment company under the 1940 Act;
- we will primarily invest within our target assets, consisting primarily of Agency RMBS and non-Agency RMBS; approximately 5% to 10% of our portfolio may include financial assets other than RMBS; and
- until appropriate investments can be identified, we will invest available cash in interest-bearing and short-term investments that are consistent with (i) our intention to qualify as a REIT, and (ii) our exemption from investment company status under the 1940 Act.

These investment guidelines may be changed from time to time by our board of directors without the approval of our stockholders.

Within the constraints of the foregoing investment guidelines, PRCM Advisers LLC has broad authority to select, finance and manage our investment portfolio. As a general matter, our investment strategy is designed to enable us to:

- build an investment portfolio consisting of Agency RMBS and non-Agency RMBS that will generate attractive returns while having a moderate risk profile;
- manage financing, interest, prepayment rate and credit risks;
- capitalize on discrepancies in the relative valuations in the mortgage market; and
- provide regular quarterly distributions to stockholders.

Within the requirements of the investment guidelines, PRCM Advisers LLC makes determinations as to the percentage of our assets that will be invested in each of our target assets. PRCM Advisers LLC s decisions depend on prevailing market conditions and may change over time in response to opportunities available in

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different interest rate, economic and credit environments. As a result, we cannot predict the percentage of our assets that will be invested in any of our target asset classes at any given time. We believe that the diversification of our portfolio of assets and the flexibility of our strategy, combined with PRCM Advisers LLC s and its affiliates expertise, will enable us to achieve attractive risk-adjusted returns under a variety of market conditions and economic cycles.

Target Assets

Our target asset classes and the principal investments we have made and expect to make are as follows:

Agency RMBS	Agency RMBS collateralized by either fixed rate mortgage loans, adjustable rate mortgage loans or hybrid mortgage loans, or derivatives thereof, including: mortgage pass-through certificates; collateralized mortgage obligations; Freddie Mac gold certificates; Fannie Mae certificates; Ginnie Mae certificates; to-be-announced forward contracts, that is pools of mortgages with specific investment terms to be issued by GSEs at a future date; and interest-only and inverse interest-only securities.
Non-Agency RMBS	Non-Agency RMBS collateralized by prime mortgage loans, Alt-A mortgage loans and subprime mortgage loans, which may have fixed rate, adjustable rate or hybrid rate terms. Non-Agency RMBS includes both senior and mezzanine RMBS. Senior RMBS refers to non-Agency RMBS that represent the senior-most tranches that is, the tranches which have the highest priority claim to cash flows from the related collateral pool, within the RMBS structure. Mezzanine RMBS refers to subordinated tranches within the collateral pool. The non-Agency RMBS we purchase may include investment-grade and non-investment grade classes, including

	non-rated securities. Hybrid mortgage loans have terms with interest rates that are fixed for a specified period of time and, thereafter, generally adjust periodically to an increment over a specified interest rate index. ARMs refer to hybrid and adjustable-rate mortgage loans which typically have interest rates that adjust periodically to an increment over a specified interest rate index.
Assets other than RMBS	Non-real estate financial assets including non-mortgage related securities and certain hedging transactions that may produce non-qualifying income for purposes of the REIT gross income tests.

Our investment portfolio at December 31, 2009 primarily consisted of RMBS. After the consummation of this offering, we expect that our investment portfolio will continue to consist primarily of RMBS, subject to our REIT qualification and our 1940 Act exemption.

Investment Activities

At December 31, 2009, we had total assets of approximately $538.4 million, of which $494.5 million, or 91.8%, represented our RMBS portfolio. At December 31, 2009, $417.8 million, or 84.5% of our RMBS portfolio was comprised of Agency RMBS, $54.1 million, or 10.9% of our RMBS portfolio was comprised of senior non-Agency RMBS, and the remaining $22.6 million, or 4.6% was comprised of other non-Agency RMBS. The remaining $43.9 million of assets consists primarily of cash, restricted cash, receivables and prepaid assets.

Competitive Advantages

Our investment strategy is focused on utilizing our underlying core strengths, described below in further detail, which we believe offer competitive advantages in the marketplace.

Significant Experience of Our Management Team

PRCM Advisers LLC s fixed income team has broad experience in managing Agency RMBS, non-Agency RMBS and other mortgage-related assets through a variety of credit and interest rate environments and has demonstrated the ability to generate attractive risk-adjusted returns under different market conditions and cycles, on both a levered and unlevered basis.

The senior members of our research and investment team have an average of 22 years of experience in mortgage-backed securities trading, including experience in performing advisory services for investment banks, funds, other investment vehicles, and other managed and discretionary accounts. Our Co-Chief Investment Officers are Steven Kuhn and William Roth. Mr. Kuhn is a Partner of Pine River, and joined the firm in January 2008. He has 16 years of experience trading RMBS and other fixed income securities for Goldman Sachs Asset Management, Citadel and Cargill. Mr. Roth joined Pine River in June 2009, and has 28 years of experience working for Salomon Brothers and Citigroup in the fixed income markets, including mortgage-backed and asset-backed securities. The fixed income investment team also includes seasoned traders, analysts and risk managers, and is backed by Pine River s extensive infrastructure in the areas of trade execution, risk management, valuation, accounting, operations, corporate governance and law. We are not assured of access to all of Pine River s investment professionals, or to the time and expertise of any particular members of Pine River s fixed income team.

Disciplined Relative Value Investment Approach

Disciplined security selection is a key element of our strategy. We are, in essence, a relative value investor in mortgage-backed securities. PRCM Advisers LLC uses a cross-product approach, conducting top-down market assessments with respect to various subsets of the RMBS market in order to identify the most attractive segments and investment opportunities. In employing this detailed analysis, PRCM Advisers LLC seeks to best capture market inefficiencies and identify the most mispriced securities. We select our RMBS based on factors that include extensive analysis of the underlying loans, including prepayment trends, average remaining life, amortization schedules, fixed versus floating interest rates, geographic concentration, property type, loan-to-value ratios and credit scores. Considering the multi-trillion dollar size of the U.S. RMBS market, we can be very selective with our investments and buy only the securities we deem to be the most attractive. We believe this holistic, relative-value approach to the non-Agency and Agency RMBS investments may achieve higher risk-adjusted returns than an approach that focuses on a single sector of the residential mortgage market.

Portfolio Construction

Our objective is to provide attractive risk-adjusted returns to our stockholders over the long-term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by constructing a well-balanced portfolio consisting primarily of RMBS, with a focus on managing various associated risks, including interest rate, prepayment, mortgage spread and financing risk. PRCM Advisers LLC uses its fixed income investment team s expertise across a broad range of asset classes within the RMBS markets to build a portfolio that seeks to balance income, cash, capital appreciation, leverage and the aforementioned risks. Through the careful and disciplined selection of assets, and continual portfolio monitoring, we seek to build and maintain an investment portfolio that provides value to stockholders over time both in absolute terms and relative to other RMBS portfolios.

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Access to PRCM Advisers LLC s Analytical Tools, Infrastructure and Expertise

Our experienced investment team constructs and manages our RMBS investment portfolio through the use of focused qualitative and quantitative analysis, which helps us manage risk on a security-by-security and portfolio basis. We rely on a variety of proprietary and third party analytic tools and models, which we customize to our needs. We focus on in-depth analysis of the numerous factors that influence our target assets, including:

- fundamental market and sector review;
- cash flow analysis;
- disciplined security selection;
- controlled risk exposure; and
- prudent balance sheet management.

We also use these tools to guide the hedging strategies developed by PRCM Advisers LLC to the extent consistent with the requirements for qualification as a REIT.

In addition, through PRCM Advisers LLC we have access to Pine River s proprietary technology management platform, called Everest, to track investments and to monitor investment risk across asset classes. Everest collects and stores real-time market data, and integrates market performance with portfolio holdings and proprietary risk models to measure the risk positions in portfolios. This measurement system portrays overall portfolio risk and risk sources.

Our ability to track real-time variables such as market specific home prices and unemployment rates provides us with valuable insights and helps with specific asset selection decisions. We believe that sophisticated analysis of both macro- and micro-economic factors will enable us to manage cash flow and distributions while preserving our stockholders capital.

Through our shared facilities and services agreement with Pine River, PRCM Advisers LLC has analytical and portfolio management capabilities to aid in security selection and risk management. We capitalize on the market knowledge and ready access to data across our target markets that PRCM Advisers LLC and its affiliates obtain through their established platform. We also benefit, through PRCM Advisers LLC, from Pine River s comprehensive finance, operational and administrative infrastructure, including its risk management and financial reporting and accounting operations, as well as its business development, legal and compliance, operations and settlement and software development teams.

Extensive Strategic Relationships and Experience of PRCM Advisers LLC and its Affiliates

PRCM Advisers LLC and its affiliates maintain extensive long-term relationships with financial intermediaries including prime brokers, investment banks, broker-dealers and asset custodians. We believe these relationships enhance our ability to source, finance, protect and hedge our investments and, thus, enable us to succeed in various credit and interest rate environments. Members of the fixed income team have many years of experience and well-established contacts within the RMBS industry, and are able to bring their personal relationships to bear for our benefit and the benefit of our stockholders.

Financing Strategy

We deploy moderate leverage to increase potential returns to our stockholders and to fund the acquisition of our assets. We are not required to maintain any particular leverage ratio. The amount of leverage we deploy for particular investments in our target assets depends upon an assessment of a variety of factors, which may include the anticipated liquidity and price volatility of our assets; the gap between the duration of assets and liabilities, including hedges; the availability and cost of financing the assets; our opinion of the credit worthiness of financing counterparties; the health of the U.S. economy and residential mortgage-related markets; our outlook for the level, slope, and volatility of interest rates; the credit quality of the loans we acquire; the collateral underlying our Agency RMBS and non-Agency RMBS; and our outlook for asset spreads relative to the LIBOR curve.

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Our primary financing sources are repurchase agreements. We may use repurchase agreements to deploy, on a debt-to-equity basis, up to ten times leverage on our Agency RMBS assets, but we are not required to maintain any particular leverage ratio. We expect under current market conditions to deploy limited leverage on our non-Agency RMBS through the use of repurchase agreements. In the future, we may pursue additional leverage in conjunction with financings that may be available from traditional private sources of lending or under programs established by the U.S. government. In the current economic climate, repurchase lenders under repurchase agreements generally advance approximately 90% to 95% of the market value of the Agency RMBS financed (meaning a 5% to 10% discount from market value, or haircut) and 50% to 65% of the market value of the non-Agency RMBS financed (meaning a 35% to 50% haircut). A significant decrease in the advance rate or an increase in the haircut could result in our having to sell securities in order to meet additional margin requirements by the lender. We expect to mitigate our risk of margin calls by deploying a prudent amount of leverage that is below what could be used under current advance rates.

In order to reduce our exposure to counterparty-related risk, we generally seek to diversify our exposure by entering into repurchase agreements with multiple counterparties. As of April 6, 2010, we had repurchase agreements with nine counterparties. At December 31, 2009, we had $411.9 million of outstanding balances under repurchase agreements with six counterparties, with a maximum net exposure (the difference between the amount loaned to us, including interest payable, and the value of the securities pledged by us as collateral, including accrued interest receivable on such securities) to any single lender of $17.3 million.

Interest Rate Hedging and Risk Management Strategy

We enter into derivative financial instruments, or hedging instruments, to hedge all or a portion of the interest rate risk on our LIBOR-based repurchase agreements. At December 31, 2009, our hedging instruments consisted solely of swaps, which are used to lock-in fixed interest rates over the term of the swap, related to a portion of our existing and anticipated future repurchase agreements. At December 31, 2009, we were a party to fixed-rate swaps with an aggregate notional amount of $100.0 million. We do not anticipate entering into any hedging instruments for speculative or trading purposes.

Management Agreement

We have entered into a management agreement with PRCM Advisers LLC, a wholly-owned subsidiary of Pine River. Pursuant to the management agreement, PRCM Advisers LLC implements our business strategy and performs certain services for us, subject to oversight by our board of directors. PRCM Advisers LLC is responsible for, among other duties, (i) performing all of our day-to-day functions, (ii) determining investment criteria in conjunction with our board of directors, (iii) sourcing, analyzing and executing investments, asset sales and financings, and (iv) performing asset management duties.

The initial term of the management agreement expires on October 28, 2012, with automatic, one-year renewals at the end of the initial term and each year thereafter. Our independent directors review PRCM Advisers LLC s performance annually and, following the initial term, the management agreement may be terminated annually by us without cause upon the vote of at least two-thirds of our independent directors or by a vote of the holders of a majority of the outstanding shares of our common stock, based upon: (i) PRCM Advisers LLC s unsatisfactory performance that is materially detrimental to us or (ii) our determination that the management fees payable to PRCM Advisers LLC are not fair, subject to PRCM Advisers LLC s right to prevent termination based on unfair fees by accepting a reduction of management fees agreed to by at least two-thirds of our independent directors. We are required to provide PRCM Advisers LLC with 180 days prior notice of such termination. Upon termination without cause, we will pay PRCM Advisers LLC a termination fee, as described below. We will also pay a termination fee to PRCM Advisers LLC if

PRCM Advisers LLC terminates the management agreement due to our material breach of such agreement. We may terminate the management agreement with 30 days prior notice from our board of directors, without payment of a termination fee, for cause, as defined in the management agreement. PRCM Advisers LLC may terminate the management agreement if we become required to register as an investment company under the 1940 Act, with such termination deemed to occur immediately before such event, and may also decline to renew the management agreement by providing us with 180 days prior notice, in either case of which we would not be required to pay a termination fee.

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Base Management Fee

The base management fee paid to PRCM Advisers LLC is 1.5% of our stockholders equity per annum, calculated and payable quarterly in arrears. There is no incentive-based or performance-based component of PRCM Advisers LLC s compensation.

For purposes of calculating the management fee, our stockholders equity means the sum of the net proceeds from all issuances of our equity securities since inception (allocated on a *pro rata* daily basis for such issuances during the fiscal quarter of any such issuance), plus our retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount that we have paid for repurchases of our common stock since inception, and excluding any unrealized gains, losses or other items that do not affect realized net income (regardless of whether such items are included in other comprehensive income or loss, or in net income). This amount will be adjusted to exclude one-time events pursuant to changes in GAAP, and certain non-cash items after discussions between PRCM Advisers LLC and our independent directors and approval by a majority of our independent directors. To the extent asset impairments reduce our retained earnings at the end of any completed calendar quarter it will reduce the base management fee for such quarter. Our stockholders equity for the purposes of calculating the base management fee could be greater than the amount of stockholders equity shown on the consolidated financial statements.

Expense Reimbursement

We reimburse PRCM Advisers LLC for (i) in the event PRCM Advisers LLC were to hire its own personnel, our allocable share of the compensation paid by PRCM Advisers LLC to its personnel serving as our principal financial officer and general counsel and personnel employed by PRCM Advisers LLC as inhouse legal, tax, accounting, consulting, auditing, administrative, information technology, valuation, computer programming and development and back-office resources to us and (ii) any amounts for personnel of PRCM Advisers LLC s affiliates arising under a shared facilities and services agreement.

Termination Fee

Upon termination of the management agreement by us without cause or by PRCM Advisers LLC due to our material breach of the management agreement, we are required to pay a termination fee equal to three times the sum of the average annual base management fee earned by PRCM Advisers LLC during the 24-month period immediately preceding the date of termination, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination.

Regulation

REIT Qualification

We intend to elect to qualify as a REIT under the Code, commencing with our taxable period ended on December 31, 2009. Our qualification as a REIT depends upon our ability to meet on a continuing basis, through actual investment and operating results, various complex requirements under the Code relating to, among other things, the sources of our gross income, the composition and values of our assets, our distribution levels and the diversity of ownership of our shares. We believe that we are organized in conformity with the requirements for qualification and taxation as a REIT under the Code, and we conduct our operations in a manner which will enable us to meet the requirements for qualification and taxation as a REIT.

As long as we qualify as a REIT, we generally will not be subject to U.S. federal income tax on the REIT taxable income we distribute currently to our stockholders. If we fail to qualify as a REIT in any taxable year and do not qualify for certain statutory relief provisions, we will be subject to U.S. federal income tax at regular corporate rates and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year during which we lost our REIT qualification. Even if we qualify for taxation as a REIT, we may be subject to certain U.S. federal, state and local taxes on our income or property.

1940 Act Exemption

We intend to conduct our operations so that we are not required to register as an investment company under the 1940 Act. The 1940 Act exempts entities that are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate, or qualifying interests. Under

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the current interpretation of the SEC s staff, in order to qualify for this exemption, we must maintain (i) at least 55% of our assets in qualifying interests (referred to as the 55% Test) and (ii) at least 80% of our assets in real estate related assets including qualifying interests (referred to as the 80% Test). In meeting the 55% Test, we treat as qualifying interests those RMBS issued with respect to an underlying pool as to which we own all of the certificates issued by the pool. RMBS that do not represent all of the certificates issued (i.e., an undivided interest) by the pool of mortgages (i.e., a whole pool) underlying such RMBS may be treated as securities separate from such underlying mortgage loans and, thus, may not be considered qualifying interests for purposes of the 55% Test; however, such RMBS would be considered real estate related assets for purposes of the 80% Test. Therefore, for purposes of the 55% Test, our ownership of these types of RMBS is limited by the provisions of the 1940 Act. If the SEC or its staff were to adopt a contrary interpretation, we could be required to sell a substantial amount of our RMBS under potentially adverse market conditions. Further, in order to ensure that at all times we qualify for this exemption from the 1940 Act, we may be precluded from acquiring RMBS whose yield is higher than the yield on RMBS that could be otherwise purchased in a manner consistent with this exemption. Accordingly, we monitor our compliance with both the 55% Test and the 80% Test in order to maintain our exempt status under the 1940 Act.

Corporate Governance

We strive to maintain an ethical workplace in which the highest standards of professional conduct are practiced.

Our board of directors is composed of a majority of independent directors. Our Audit, Nominating and Corporate Governance and Compensation Committees are composed exclusively of independent directors.

In order to foster the highest standards of ethics and conduct in all of our business relationships, we have adopted a Code of Business Conduct and Ethics and Corporate Governance Guidelines, which cover a wide range of business practices and procedures that apply to all of our directors, officers and employees. In addition, we have implemented Whistle Blowing Procedures for Accounting and Auditing Matters that set forth procedures by which any officer or employee may raise, on a confidential basis, concerns regarding any questionable or unethical accounting, internal accounting controls or auditing matters with our Audit Committee.

We have an insider trading policy that prohibits any of our directors, officers or employees from buying or selling our common and preferred stock on the basis of material nonpublic information and prohibits communicating material nonpublic information to others.

We have a formal internal audit function, through the current use of an independent, outsourced firm, to further the effective functioning of our internal controls and procedures. Our internal audit plan, which is approved annually by our Audit Committee, is based on a formal risk assessment and is intended to provide management and our Audit Committee with an effective tool to identify and address areas of financial or operational concerns and to ensure that appropriate controls and procedures are in place. We have implemented Section 404 of the Sarbanes-Oxley Act of 2002, as amended, or the SOX Act, which requires an evaluation of internal control over financial reporting in association with our financial statements as of December 31, 2009.

Competition

Our net income will depend, in large part, on our ability to acquire assets at favorable spreads over our borrowing costs. In acquiring our target assets, we will compete with other REITs, specialty finance companies, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, financial institutions, governmental bodies and other entities. Some of these entities may not be subject to the same regulatory constraints that we are (i.e., REIT compliance or maintaining an exemption under the 1940 Act). In addition, there are numerous REITs with similar asset acquisition objectives, including a number that have been recently formed, and others may be organized in the future. These other REITs will increase competition for the available supply of RMBS. Many of our competitors are significantly larger than us, have access to greater capital and other resources and may have other advantages over us. In addition, some of our competitors may have higher risk tolerances or

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different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than us. Current market conditions may attract more competitors, which may increase the competition for sources of financing. An increase in the competition for sources of funding could adversely affect the availability and cost of financing, and thereby adversely affect the market price of our common stock.

In the face of this competition, we have access to PRCM Advisers LLC s professionals and their industry expertise, which may provide us with a competitive advantage and will help us assess investment risks and determine appropriate pricing for certain potential investments. In addition, we believe that current market conditions may have adversely affected the financial condition of certain competitors. Thus, our organization, with no legacy portfolio prior to October 28, 2009, may be able to compete more effectively for attractive investment opportunities. However, we may not be able to achieve our business goals or expectations due to the competitive risks that we face. For additional information concerning these competitive risks, see *Risk Factors Risks Related to Our Business We operate in a highly competitive market and competition may limit our ability to acquire desirable assets*.

Employees

We are managed by PRCM Advisers LLC pursuant to the management agreement between PRCM Advisers LLC and us. All of our officers are partners or employees of PRCM Advisers LLC or its affiliates. We have no direct employees.

Policies with Respect to Certain Other Activities

If our board of directors determines that additional funding is necessary or appropriate, we may raise such funds through additional offerings of equity or debt securities or the retention of cash flow (subject to provisions in the Code concerning distribution requirements and the taxability of undistributed REIT taxable income). In the event that our board of directors determines to raise additional equity capital, it has the authority, without stockholder approval, to issue additional common stock or preferred stock in any manner and on such terms and for such consideration as it deems appropriate, at any time.

As of the date of this filing, we do not intend to offer equity or debt securities in exchange for property. We have not in the past repurchased or otherwise reacquired our shares, but may do so in the future, subject to the requirements of the MGCL.

As of the date of this filing, we do not intend to invest in the securities of other REITs, other entities engaged in real estate activities or securities of other issuers for the purpose of exercising control over such entities.

We have not in the past made loans to third parties in the ordinary course of business for investment purposes, but may do so in the future. As of the date of this prospectus, we do not intend to underwrite the securities of other issuers.

We intend to finance the acquisition of investments with traditional forms of financing, such as repurchase agreements. We intend to engage in the purchase and sale of investments.

We furnish our stockholders with annual reports containing consolidated financial statements audited by our independent registered public accountants and file quarterly reports with the SEC containing unaudited consolidated financial statements for each of the first three quarters of each fiscal year.

Our board of directors may change any of these policies without prior notice, or a vote of our stockholders, other than filing of annual and quarterly reports with the SEC which is required by law.

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MANAGEMENT

General

We are externally managed and advised by PRCM Advisers LLC, a wholly-owned subsidiary of our sponsor, Pine River. Pursuant to the terms of the management agreement, PRCM Advisers LLC provides us with our senior management team, including officers, along with appropriate support personnel. Each of our officers is an employee or partner of Pine River. We do not have any employees. PRCM Advisers LLC is at all times subject to the supervision and oversight of our board of directors.

Our Directors and Executive Officers

Our board of directors consists of seven directors, comprised of Brian C. Taylor, Thomas Siering, Stephen G. Kasnet, William W. Johnson, W. Reid Sanders, Mark D. Ein and Peter Niculescu. Of these seven directors, we believe that each of them, other than Messrs. Taylor, Siering and Ein, are considered independent in accordance with the requirements of the NYSE Amex. Our directors are elected at each annual meeting of stockholders to serve until the next annual meeting of stockholders and until their successors are duly elected and qualify. Our independent directors meet regularly in executive sessions without the presence of our corporate officers or non-independent directors.

Each of our executive officers is an employee or partner of Pine River. Officers serve at the pleasure of our board of directors.

The following sets forth certain information concerning the persons who serve as our directors and executive officers:

Name	Age	Position
Brian C. Taylor	45	Chairman and Director
Mark D. Ein	45	Non-Executive Vice Chairman
Thomas Siering	50	Chief Executive Officer, President and Director
Steven Kuhn	40	Co-Chief Investment Officer
William Roth	52	Co-Chief Investment Officer
Jeffrey Stolt	46	Chief Financial Officer and Treasurer
Timothy O Brien	51	General Counsel and Secretary
Stephen G. Kasnet	64	Independent Director
William W. Johnson	48	Independent Director
W. Reid Sanders	60	Independent Director
Peter Niculescu	50	Independent Director

Information About the Directors and Executive Officers

Mark D. Ein is the non-executive Vice Chairman of our board of directors. Mr. Ein has been a director since the merger with Capitol in October of 2009. Mr. Ein served as Capitol s Chief Executive Officer and a member of its board of directors since its inception. Mr. Ein is the Founder of Venturehouse Group, LLC, a holding company that creates, invests in and builds companies, and has served as its Chief Executive Officer since 1999. Venturehouse s portfolio includes or has included the seed investment in Matrics Technologies in August 2000 (sold to Symbol Technologies in September 2004), the lead investment in the buyout of Cibernet Corporation from the CTIA in March

2003 (sold to MACH S.á.r.l. in April 2007), the acquisition of VSGi from Net2000 Communications, and an early investment in XM Satellite Radio (NASDAQ:XMSR). He is also the President of Leland Investments, a private investment firm. An entity owned by Mr. Ein is also the majority owner and managing member of Kastle Holding Company LLC, which through its subsidiaries conducts the business of Kastle Systems, LLC, a provider of building and office security systems that was acquired in January 2007. He is the Co-Chairman of Kastle Systems. Mr. Ein is also the founder and owner of the Washington Kastles, the World Team Tennis franchise in Washington, D.C. From 1992 to 1999, Mr. Ein was a principal with The Carlyle Group, a global private equity firm. Mr. Ein worked for Brentwood Associates, a West Coast growth-focused private equity firm, from 1989 to 1990 and for Goldman, Sachs & Co. in the real estate and mortgage finance group from 1986 to 1989. Mr. Ein is a director of MACH S.á.r.l., a telecommunications process solutions company, and is the chairman of the board of VSGi, a video conferencing, telepresence, and audi-visual integration company. He serves on the board of directors of The Economic Club of Washington D.C., a non-profit corporation formed to address global economic issues, The District of Columbia College Access Program (DC-CAP), a non-profit organization supporting the academic success of D.C. area public high school students, The District of Columbia Public Education Fund, a non-profit organization fostering achievement in public education, and The Potomac Officers Club, a D.C. area non-profit business and trade organization. He previously served on the Trustee s Council of the National Gallery of Art and the boards of the Wolf Trap Foundation, The Washington Tennis and Education Fund, the Executive Committee of the Federal City Council, The Foundation for the National Institutes of Health (NIH), and the SEED School and Foundation. He was the Co-Chairman of the 2000 Corporate Campaign for The Phillips Collection. Mr. Ein received a B.S. in Economics with a concentration in Finance from the University of Pennsylvania s Wharton School of Finance and an M.B.A. from the Harvard Business School. Mr. Ein was appointed as a director pursuant to contractual rights of Capitol granted in the merger agreement with Capitol. We believe Mr. Ein is an appropriate director to provide continuity for Capitol s common stock and warrant holders and the benefits he brings to our board with his background as an entrepreneur, investment banker and investor.

William W. Johnson is an independent member of our board of directors. Mr. Johnson has been a director since the merger with Capitol in October of 2009. Mr. Johnson is currently a Partner and Deputy Head of Asset Management at Perella Weinberg Partners in New York, a privately owned financial services firm. Previously, he was a Managing Director of J.P. Morgan, a financial services firm, from 2006 to 2009, where he held senior roles including Divisional Management and Risk Committee Member, Head of Proprietary Positioning Business, and Head of Tax-Exempt Capital Markets. From 2004 to 2005, Mr. Johnson was a private investor. From 2001 to 2003, Mr. Johnson was President of Paloma Partners, a private capital management company in Greenwich, Connecticut. From 1984 to 2001, Mr. Johnson worked for UBS and its predecessors in Chicago, Singapore, London and Basel. He began his career at UBS in currency options trading and served in several senior management functions including Divisional Management and Risk Committee Member and Global Head of Treasury Products. Mr. Johnson received a B.S. degree from the University of Pennsylvania Wharton School in 1984, and a M.B.A. from the University of Chicago in 1988. Mr. Johnson was appointed as a director pursuant to contractual rights of Pine River granted in the merger agreement with Capitol. We believe Mr. Johnson is an appropriate director because of his knowledge of financial markets and trading, and his career in financial markets.

Stephen G. Kasnet is an independent member of our board of directors. Mr. Kasnet has been a director since the merger with Capitol in October of 2009. He is also our Lead Independent Director. Mr. Kasnet has also been a director of Columbia Laboratories, Inc., a specialty pharmaceuticals company (NASDAQ:CBRX) since August 2004 and Chairman of the Board since November 2004. He was the Chairman of Dartmouth Street Capital LLC, a private investment firm, from 2007 through October 2009. He was also the President and Chief Executive Officer of Raymond Property Company LLC, a real estate company, from 2007 through October 2009. From 2000 to 2006, he was President and Chief Executive Officer of Harbor Global Company, Ltd., an asset management, natural resources and real estate investment company, and Chairman of the PIOglobal, a Russian real estate investment fund. From 1995 to 1999, Mr. Kasnet was a director and member of the Executive Committee of The Bradley Real Estate Trust. He was Chairman of Warren Bank from 1990 to 2003. He has also held senior management positions with other financial organizations, including Pioneer Group, Inc., First Winthrop Corporation and Winthrop Financial Associates, and Cabot and Forbes. He serves as Chairman of the Board of Rubicon Ltd., a forestry company, is a director of Tenon Ltd., a wood products company, and serves as a director of First Ipswich Bancorp, a bank holding company. He is also a trustee and vice president of the board of the Governor s Academy, a private coed boarding high school in Byfield, MA. Mr. Kasnet received a B.A. from the University of Pennsylvania in 1966. Mr. Kasnet was appointed as a director pursuant to contractual rights of Pine River granted in the merger agreement with Capitol. We believe Mr. Kasnet is an appropriate director based on his audit committee experience, and his past experience as a director of public companies.

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Steven Kuhn is our Co-Chief Investment Officer. Mr. Kuhn has been an executive officer since the merger with Capitol in October of 2009. Mr. Kuhn is a Partner Head of Fixed Income Trading at Pine River. Prior to joining Pine River in 2008, Mr. Kuhn was a Vice President and Portfolio Manager at Goldman Sachs & Co., an investment banking and securities firm, based in New York and Beijing from 2002 to 2007, where he was part of a team that managed approximately $40 billion in mortgage-backed securities. While he was in Beijing, Mr. Kuhn provided training to sovereign wealth fund clients and voluntarily taught Finance to students from Peking University and Tsinghua University. From 1999 to 2002, Mr. Kuhn was a Japanese convertible bond trader at Citadel Investment Group in Chicago. Prior to that, Mr. Kuhn was head of mortgage-backed securities trading at Cargill in Minnetonka, Minnesota. Mr. Kuhn received a B.A. in Economics with Honors from Harvard University in 1991.

Peter Niculescu is an independent member of our board of directors. Mr. Niculescu has been a director since the merger with Capitol in October of 2009. Since 2009, Mr. Niculescu has also been a Partner and Head of Fixed Income Advisory at CMRA, a risk management firm providing consulting and litigation support services to major US and international financial services companies and institutional investors. Prior to joining CMRA, Mr. Niculescu ran the Capital Markets division at Fannie Mae, a government sponsored entity, from 2002 to 2008. During the 1990s, he was a Managing Director at Goldman Sachs & Co. in its mortgage research and fixed income strategy group. Mr. Niculescu received a Bachelors of Economics from the Victoria University of Wellington in New Zealand in 1979 and his Ph.D. in Economics from Yale University in 1985. Mr. Niculescu is a Chartered Financial Analyst. Mr. Niculescu was appointed as a director pursuant to contractual rights of Capitol granted in the merger agreement with Capitol. We believe Mr. Niculescu is an appropriate director because of his experience in trading and mortgage-backed securities, particularly during his tenure as an officer with Fannie Mae.

Timothy O Brien is our General Counsel and Secretary. Mr. O Brien has been an executive officer since the merger with Capitol in October of 2009. Mr. O Brien is a Partner of Pine River and has served as General Counsel and Chief Compliance Officer of Pine River since 2007. From 2004 to 2006, Mr. O Brien served as Vice President and General Counsel of NRG Energy, Inc., a publicly-listed power generation company. Mr. O Brien served as Deputy General Counsel of NRG Energy, Inc. from 2000 to 2004 and Assistant General Counsel from 1996 to 2000. Prior to joining NRG Energy, Inc., Mr. O Brien was an associate at the law firm of Sheppard, Mullin, Richter & Hampton in Los Angeles and San Diego, California. He received a B.A. in History from Princeton University in 1981 and a J.D. from the University of Minnesota Law School in 1986.

William Roth is our Co-Chief Investment Officer. Mr. Roth has been an executive officer since the merger with Capitol in October of 2009. Mr. Roth also serves as Portfolio Manager of the New York office of Pine River. Prior to joining Pine River in 2009, Mr. Roth was at Citigroup, a financial services organization, and its predecessor firm, Salomon Brothers Inc., for 28 years where he was named a Director in 1987 and a Managing Director in 1997. From 2004 to 2009, Mr. Roth managed a proprietary trading book at Citigroup with particular focus on mortgage and asset-backed securities. From 1994 to 2004, Mr. Roth was part of the Salomon/Citi New York Mortgage Sales Department. From 1981 to 1994, Mr. Roth was based in Chicago and managed the Chicago Financial Institutions Sales Group for Salomon Brothers. He received an M.B.A. with a concentration in Finance from the University of Chicago Graduate School of Business in 1981 and a B.S. in Finance and Economics from Miami University in Oxford, Ohio in 1979.

W. Reid Sanders is an independent member of our board of directors. Mr. Sanders has been a director since the merger with Capitol in October of 2009. He is a director and member of the audit committee of Mid-America Apartment Communities, Inc., a Delaware REIT that owns and operates apartment complexes, (NYSE: MAA). Mr. Sanders is also the President of Sanders Properties, Inc., a real estate company, a director of Independent Bank, a bank holding company, serves on the Investment Committee at Cypress Realty, a real estate company, and is on the Advisory Board of SSM Venture Partners III, L.P., a private venture capital firm. He is the former Chairman at Two

Rivers Capital Management, and his former directorships include Harbor Global Company Ltd., an asset management, natural resources and real estate investment company, PioGlobal Asset Management, a Russian private investment management company, Pioneer Group Inc., a global investment management firm, and TBA Entertainment Corporation, a strategic communications and entertainment marketing company. Mr. Sanders was the Co-Founder and former Executive Vice President of

Southeastern Asset Management, and the former President of Longleaf Partners Mutual Funds, a family of funds in Memphis from 1975 2000. He served as the Investment Officer at First Tennessee Investment Management, the investment management division of First Horizon National Corporation, from 1973 1975. Prior to being at First Tennessee, Mr. Sanders worked in Credit Analysis and Commercial Lending at Union Planters National Bank from 1971 1972. Mr. Sanders is a Trustee of the Hugo Dixon Foundation, the Dixon Gallery and Gardens, the Hutchison School, Campbell Clinic Foundation, The Jefferson Scholars Foundation, TN Shakespeare Company, and formerly a Trustee of Rhodes College. He received a Bachelors of Economics from the University of Virginia in 1971. Mr. Sanders was appointed as a director pursuant to contractual rights of Pine River granted in the merger agreement with Capitol. We believe Mr. Sanders is an appropriate director because of his broad business experience and expertise, and sound judgment, as well as his expertise with audits and financial statements.

Thomas Siering is our Chief Executive Officer and President and a member of our board of directors. Mr. Siering has been a director and executive officer since Two Harbors was incorporated in May 2009. Mr. Siering is a Partner Head of Fundamental Strategies at Pine River. Prior to joining Pine River in 2006, Mr. Siering was head of the Value Investment Group at EBF & Associates, a private investment firm, from 1999 until 2006. During that period, he was also the manager for Merced Partners, LP, a private investment firm, and Tamarack International Limited, a closed end, non-diversified investment management company. Mr. Siering was named a Partner at EBF & Associates in 1997. Mr. Siering joined EBF & Associates in 1989 as a trader. From 1987 to 1989, Mr. Siering held various positions in the Financial Markets Department at Cargill, Inc. From 1981 until 1987, Mr. Siering was employed in the Domestic Soybean Processing Division at Cargill in both trading and managerial roles. Mr. Siering holds a B.B.A. from the University of Iowa with a major in Finance. Mr. Siering was appointed as a director pursuant to contractual rights of Pine River granted in the merger agreement with Capitol. We believe Mr. Siering is an appropriate director because of his knowledge of PRCM Advisers LLC and its affiliate organizations, which will help ensure that adequate resources are devoted to Two Harbors by PRCM Advisers LLC. Mr. Siering plays a key liaison role between day-to-day management of Two Harbors and our independent directors. We believe Mr. Siering is also an appropriate director because of his investment and trading expertise.

Jeffrey Stolt is our Chief Financial Officer and Treasurer. Mr. Stolt has been an executive officer since the merger with Capitol in October of 2009. Mr. Stolt also is a Partner and Chief Financial Officer of Pine River. Prior to co-founding Pine River in 2002, Mr. Stolt was the Controller at EBF & Associates from 1997 to 2002. In this role, Mr. Stolt oversaw the preparation of all fund accounting statements, managed the offshore administrator relationship, managed the audit process and was responsible for tax planning and reporting. Mr. Stolt began employment with EBF in 1989. Prior to that, Mr. Stolt was an accountant in Cargill, Inc. s Financial Markets Department from 1986 until 1989. Mr. Stolt received a B.S. degree in Accounting and Finance from the Minnesota State University in 1986.

Brian C. Taylor is the Chairman of our board of directors. Mr. Taylor has been a director since Two Harbors was incorporated in May 2009. Mr. Taylor is the Chief Executive Officer and Chief Investment Officer of Pine River. Mr. Taylor founded Pine River in 2002 and is responsible for management of the business and oversight of its funds. Prior to Pine River s inception, Mr. Taylor was with EBF & Associates from 1988 to 2002; he was named head of the convertible arbitrage group in 1994 and Partner in 1997. His responsibilities included portfolio management, marketing, product development and trading information systems development. Mr. Taylor received a B.S. from Millikin University in Decatur, Illinois and an M.B.A. from the University of Chicago. Mr. Taylor passed the Illinois Certified Public Accountant Examination in 1986. Mr. Taylor was appointed as a director pursuant to contractual rights of Pine River granted in the merger agreement with Capitol. We believe Mr. Taylor is an appropriate director because of his knowledge of PRCM Advisers LLC and its affiliate organizations. He is able to help ensure that adequate resources are devoted to Two Harbors by PRCM Advisers LLC. Mr. Taylor plays a key liaison role between day-to-day management of Two Harbors and our independent directors. We believe Mr. Taylor is also an appropriate director because of his investment and trading expertise.

Independence of Directors

As a result of our securities being listed on the NYSE Amex, we adhere to the rules of that exchange in determining whether a director is independent. The NYSE Amex requires that a majority of the board be composed of independent directors, which is defined generally as a person other than an executive officer or employee of the company or its subsidiaries or any other individual having a relationship, which, in the opinion of the company s board of directors, would interfere with the director s exercise of independent judgment in carrying out the responsibilities of a director. Consistent with these considerations, our board of directors has affirmatively determined that Stephen G. Kasnet, William W. Johnson, W. Reid Sanders and Peter Niculescu are independent directors.

Our Board Committees

Our board of directors has formed an audit committee, a compensation committee and a nominating and corporate governance committee and has adopted charters for each of these committees. Each of these committees has four directors and is composed exclusively of independent directors, as defined by the listing standards of the NYSE Amex. The compensation committee is composed exclusively of individuals intended to be, to the extent required by Rule 16b-3 of the Exchange Act, non-employee directors and will, at such times as we are subject to Section 162(m) of the Code, qualify as outside directors for purposes of Section 162(m) of the Code.

Audit Committee

The members of our audit committee are Stephen G. Kasnet, William W. Johnson, W. Reid Sanders and Peter Niculescu. Mr. Kasnet serves as chairman of the audit committee. Each is an independent director under the NYSE Amex listing standards. The audit committee is responsible for engaging independent certified public accountants, preparing audit committee reports, reviewing with the independent certified public accountants the plans and results of the audit engagement, approving professional services provided by the independent certified public accountants, reviewing the independence of the independent certified public accountants, considering the range of audit and non-audit fees and reviewing the adequacy of our internal accounting controls.

The audit committee is, and will at all times be, composed exclusively of independent directors as defined under the NYSE Amex listing standards and who otherwise meet the NYSE listing standards. Each member of the audit committee is able to read and understand fundamental financial statements, including a company s balance sheet, income statement and cash flow statement.

In addition, a listed company must certify that the committee has and will continue to have at least one member who is financially sophisticated in that he or she has past employment experience in finance or accounting, requisite professional certification in accounting, or other comparable experience or background that results in the individual s financial sophistication. The board of directors has determined that Mr. Kasnet satisfies the definition of financial sophistication and also qualifies as an audit committee financial expert, as defined under rules and regulations of the SEC.

Compensation Committee

The compensation committee consists of Stephen G. Kasnet, W. Reid Sanders, William W. Johnson and Peter Niculescu, each of whom is an independent director. Mr. Sanders serves as chairman of the compensation committee. The principal functions of the compensation committee are to:

- evaluate the performance of our officers,
- review any compensation payable to our directors and officers,
- evaluate the performance of PRCM Advisers LLC,
- review the compensation and fees payable to PRCM Advisers LLC under the management agreement,

prepare compensation committee reports, and

administer the issuance of any common stock or other equity awards issued to personnel of PRCM Advisers LLC or Pine River who provide services to us.

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Nominating and Corporate Governance Committee

The nominating and corporate governance committee consists of Stephen G. Kasnet, William W. Johnson, W. Reid Sanders and Peter Niculescu, each of whom is an independent director under the NYSE Amex listing standards. Mr. Johnson serves as chairman of the nominating and corporate governance committee. The nominating and corporate governance committee is responsible for seeking, considering and recommending to the board of directors qualified candidates for election as directors and approves and recommends to the full board of directors the appointment of each of our executive officers. It also periodically prepares and submits to the board of directors for adoption the committee s selection criteria for director nominees. It reviews and makes recommendations on matters involving the general operation of the board of directors and our corporate governance, and annually recommends to the board of directors nominees for each committee of the board of directors. In addition, the committee will annually facilitate the assessment of the board of directors performance as a whole and of the individual directors and report thereon to the board of directors.

Our Director Compensation

We pay a $100,000 annual director s fee to each of our independent directors who are not our officers or employees, payable half in cash and half in shares of our restricted stock. Directors who serve during the period between consummation of the Capitol merger on October 28, 2009 and completion of our first annual meeting of stockholders will also receive a one-time bonus of $50,000 immediately following the meeting, payable half in cash and half in shares of our restricted stock. All members of our board of directors are reimbursed for their costs and expenses of serving on the board of directors, including costs and expenses of attending all meetings of our board of directors and its committees. We pay an additional annual fee of $25,000 to the chairman of the audit committee of the board of directors, payable half in cash and half in shares of restricted stock. Fees to the directors made by issuance of shares will be based on the value of such shares of common stock at the date of issuance.

As a component of the annual director s fee of $100,000, we grant annual restricted share awards of shares of common stock with a market value of $50,000 on the first business day after our annual meeting of stockholders to each director who is not our officer or employee and who is on our board of directors at the close of such meeting. All equity grants will vest in three annual installments commencing on the date of the grant, as long as such director is serving as a board member on the vesting date.

The following table shows the compensation of the company s non-employee directors for services in all capacities to us in fiscal 2009.

Name	Fees Earned or Paid in Cash ($)	Stock Awards[(1)] ($)	Option Awards[(3)] ($)	Non-Equity Incentive Compensation ($)	Change in Pension Value and Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
Stephen G. Kasnet	62,500	62,500	N/A	N/A	N/A	N/A	125,000
William W. Johnson	50,000	50,000	N/A	N/A	N/A	N/A	100,000
W. Reid Sanders	50,000	50,000	N/A	N/A	N/A	N/A	100,000
Peter Niculescu	50,000	50,000	N/A	N/A	N/A	N/A	100,000

(1) Represents the aggregate grant date fair value computed in accordance with FASB ASC Topic 718.

Compensation Committee Interlocks and Insider Participation

None of the members of our compensation committee or our nominating and governance committee is or has been employed by us. None of our executive officers currently serves, or in the past three years has served, as a member of the board of directors or compensation committee of another entity that has one or more executive officers serving on our board of directors or our nominating and governance committee except that each of Mr. Brian Taylor, Mr. Tom Siering, Mr. Jeffrey Stolt and Mr. Timothy O Brien participate in making compensation decisions for officers and employees of Pine River and its affiliates.

Our Executive Compensation

Because the management agreement provides that PRCM Advisers LLC assumes principal responsibility for managing our affairs, our officers, in their capacities as such, do not receive cash compensation directly from us. Further, although we generally have no obligation to reimburse PRCM Advisers LLC for the salary, bonus, benefit and other compensation costs of the personnel of PRCM Advisers LLC and its affiliates who provide services to us under the management agreement, we reimburse PRCM Advisers LLC for (i) in the event PRCM Advisers LLC were to hire its own personnel, our allocable share of the compensation paid by PRCM Advisers LLC to its personnel serving as our principal financial officer and general counsel and personnel employed by PRCM Advisers LLC as in-house legal, tax, accounting, consulting, auditing, administrative, information technology, valuation, computer programming and development and back-office resources to us, and (ii) any amounts for personnel of PRCM Advisers LLC s affiliates arising under the shared facilities and services agreement. In their capacities as officers or personnel of PRCM Advisers LLC or its affiliates, they devote such portion of their time to our affairs as is necessary to enable us to operate our business. See *Our Manager and the Management Agreements*.

PRCM Advisers LLC compensates each of our executive officers. We pay PRCM Advisers LLC a management fee and PRCM Advisers LLC uses the proceeds from the management fee in part to pay compensation to its and Pine River s officers and personnel.

Compensation Discussion and Analysis

We have not paid, and we do not currently intend to pay, any cash or equity compensation to any of our officers and we do not currently intend to adopt any policies with respect thereto. We have engaged PRCM Advisers LLC as our manager pursuant to the terms of the management agreement. See *Our Manager and the Management Agreement* for a description of the terms of the management agreement, including the management fees payable to PRCM Advisers LLC thereunder and our reimbursement obligations to PRCM Advisers LLC.

Under our management agreement, PRCM Advisers LLC has agreed to provide us with our senior management team, including officers, along with appropriate support personnel. Because neither we nor PRCM Advisers LLC have any employees or separate facilities, PRCM Advisers LLC has entered into a shared facilities and services agreement with Pine River, its parent company, pursuant to which PRCM Advisers LLC is provided with the personnel, services and resources necessary for PRCM Advisers LLC to perform its obligations and responsibilities under the management agreement. Our officers are partners and employees of Pine River and receive their compensation from Pine River. Pine River makes all decisions relating to the compensation of our officers based on such factors as Pine River may determine are appropriate. The fees that we pay PRCM Advisers LLC under the management agreement are, through the distributions of PRCM Advisers LLC s income to its parent, Pine River, one of the sources of funds that Pine River may use to compensate our officers.

Certain Risks With Respect to Compensation

We do not believe our compensation policies and practices are reasonably likely to have a material adverse effect on Two Harbors. We are externally managed by PRCM Advisers LLC pursuant to the terms of a management agreement. Compensation decisions regarding the personnel who manage our affairs are therefore made by PRCM Advisers LLC and its parent company, Pine River, and all such compensation comes either from the fixed management fee that we pay to PRCM Advisers LLC, or via reimbursement of a portion of the salaries of certain operating personnel at Pine River who devote time to our affairs. We do not directly pay our officers any compensation, including any performance based bonuses. We have not granted our officers any equity awards, and any such awards in the future are subject to the review and approval of the compensation committee of our board of directors.

The base fee under our management agreement is calculated based on a percentage of stockholder equity and is payable quarterly. Calculation of the management fee, therefore, is not primarily dependent upon our financial performance or the performance of our management, thus the management fee does not create an incentive for management to take excessive or unnecessary risks. Specifically, the use of stockholders equity as the base for the calculation does not result in leveraged pay-out curves, steep pay-out cliffs, or set unreasonable goals and thresholds, each of which can promote excessive and unnecessary risks.

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Our independent directors review PRCM Advisers LLC s performance and the management fees quarterly, providing a check upon any improper effort by management to increase compensation payments indirectly via the pass-through of costs. The management fee itself cannot be increased or revised without the approval of the independent directors. Moreover, the management agreement provides for the termination of the agreement after the initial three year term, or for cause. Although termination under the foregoing circumstances may require the payment of a significant termination fee, we believe it is still a deterrent against excessive and unnecessary risk taking.

Our 2009 Equity Incentive Plan

We have adopted a 2009 equity incentive plan to provide incentive compensation to attract and retain qualified directors, officers, advisors, consultants and other personnel, including PRCM Advisers LLC and affiliates and personnel of PRCM Advisers LLC and its affiliates, and any joint venture affiliates of ours. The 2009 equity incentive plan is administered by the compensation committee appointed by our board of directors. The 2009 equity incentive plan permits the granting of restricted shares of common stock, phantom shares, dividend equivalent rights and other equity-based awards.

Administration

The 2009 equity incentive plan is administered by the compensation committee. The compensation committee, appointed by our board of directors, has the full authority to administer and interpret the 2009 equity incentive plan, to authorize the granting of awards, to determine the eligibility of directors, officers, advisors, consultants and other personnel, including PRCM Advisers LLC and affiliates and personnel of PRCM Advisers LLC and its affiliates, and any joint venture affiliates of ours, to receive an award, to determine the number of shares of common stock to be covered by each award (subject to the individual participant limitations provided in the 2009 equity incentive plan), to determine the terms, provisions and conditions of each award (which may not be inconsistent with the terms of the 2009 equity incentive plan), to prescribe the form of instruments evidencing awards and to take any other actions and make all other determinations that it deems necessary or appropriate in connection with the 2009 equity incentive plan or the administration or interpretation thereof. In connection with this authority, the compensation committee may, among other things, establish performance goals that must be met in order for awards to be granted or to vest, or for the restrictions on any such awards to lapse. The compensation committee administering the 2009 equity incentive plan consists of four non-employees directors, each of whom is intended to be, to the extent required by Rule 16b-3 of the Exchange Act, a non-employee director and will, at such times as we are subject to Section 162(m) of the Code, qualify as an outside director for purposes of Section 162(m) of the Code, or, if no committee exists, the board of directors. References below to the compensation committee include a reference to the board of directors for those periods in which the board of directors is acting.

Available Shares

Our 2009 equity incentive plan provides for grants of restricted common stock, phantom shares, dividend equivalent rights and other equity-based awards, subject to a ceiling of 200,000 shares available for issuance under the plan. The plan allows for our board of directors to expand the types of awards available under the plan to include LTIP units in the future. The maximum number of shares that may underlie awards in any one year to any eligible person may not exceed 100,000. If an award granted under the 2009 equity incentive plan expires or terminates, the shares subject to any portion of the award that expires or terminates without having been exercised or paid, as the case may be, will again become available for the issuance of additional awards. Unless previously terminated by our board of directors, no new award may be granted under the 2009 equity incentive plan after the tenth anniversary of the date that such plan was initially approved by our board of directors. No award may be granted under our 2009 equity incentive plan to any person who, assuming payment of all awards held by such person, would own or be deemed to own more than 9.8% of the outstanding shares of our common stock.

On October 26, 2009, we granted 22,159 shares of restricted common stock to our independent directors pursuant to the 2009 equity incentive plan. The estimated fair value of these awards was $9.59 per share, based on the closing price of Capitol s common stock on the NYSE Amex on such date. The grants will vest in three annual installments commencing on the date of the grant, as long as such director is serving as a board member on the vesting date.

Awards Under the Plan

Restricted Shares of Common Stock. A restricted share award is an award of shares of common stock that is subject to restrictions on transferability and such other restrictions, if any, the compensation committee may impose at the date of grant. Grants of restricted shares of common stock will be subject to vesting schedules as determined by the compensation committee. The restrictions may lapse separately or in combination at such times, under such circumstances, including, without limitation, a specified period of employment or the satisfaction of pre-established criteria, in such installments or otherwise, as the compensation committee may determine. Except to the extent restricted under the award agreement relating to the restricted shares of common stock, a participant granted restricted shares of common stock has all of the rights of a stockholder, including, without limitation, the right to vote and the right to receive dividends on the restricted shares of common stock. Although dividends may be paid on restricted shares of common stock, whether or not vested, at the same rate and on the same date as on shares of our common stock, holders of restricted shares of common stock are prohibited from selling such shares until they vest.

Phantom Shares. Phantom shares, when issued, will reduce the number of shares available for grant under the 2009 equity incentive plan and will vest as provided in the applicable award agreement. A phantom share represents a right to receive the fair value of a share of common stock, or, if provided by the compensation committee, the right to receive the fair value of a share of common stock in excess of a base value established by the compensation committee at the time of grant. Phantom shares may generally be settled in cash or by transfer of shares of common stock (as may be elected by the participant or the compensation committee, as may be provided by the compensation committee at grant). The compensation committee may, in its discretion and under certain circumstances, permit a participant to receive as settlement of the phantom shares installments over a period not to exceed ten years. Unless otherwise determined by the compensation committee, the holders of awards of phantom shares will be entitled to receive dividend equivalents, which shall be payable at such time that dividends are paid on outstanding shares.

LTIP Units. If our board of directors expands the types of awards under the plan to include LTIP units, it is expected that such units will be created as a special class of limited liability company interests in the Subsidiary LLC. The terms of any such awards will be determined by our board of directors at the time of such expansion.

Other Share-Based Awards. The 2009 equity incentive plan authorizes the granting of other awards based upon shares of our common stock (including the grant of securities convertible into shares of common stock and share appreciation rights), subject to terms and conditions established at the time of grant.

Change in Control

Under our 2009 equity incentive plan, a change in control is defined as the occurrence of any of the following events: (i) the acquisition of more than 50% of our voting shares by any person; (ii) the sale or disposition of all or substantially all of our assets; (iii) a merger, consolidation or statutory share exchange where our stockholders immediately prior to such event hold less than 50% of the voting power of the surviving or resulting entity; (iv) during any 12-calendar month period, our directors, including subsequent directors recommended or approved by our directors, at the beginning of such period cease for any reason other than due to death to constitute a majority of our board of directors; or (v) stockholder approval of our liquidation or dissolution. Notwithstanding the foregoing, no event or condition described in clauses (i) through (v) above shall constitute a change in control if it results from a transaction between us and PRCM Advisers LLC or an affiliate of PRCM Advisers LLC.

Upon a change in control, the compensation committee may make such adjustments as it, in its discretion, determines are necessary or appropriate in light of the change in control, but only if the compensation committee determines that the adjustments do not have an adverse economic impact on the participants (as determined at the time of the adjustments).

Amendments and Termination

Our board of directors may amend, alter or discontinue the 2009 equity incentive plan but cannot take any action that would impair the rights of a grantee with respect to grants previously made without such

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grantee s consent. To the extent necessary and desirable, the board of directors must obtain approval of our stockholders for any amendment that would:

other than through adjustment as provided in the 2009 equity incentive plan, increase the total number of shares of common stock reserved for issuance under the 2009 equity incentive plan;
change the class of officers, directors, employees, consultants and advisors eligible to participate in the 2009 equity incentive plan;
reprice any awards under the 2009 equity incentive plan; or
otherwise require such approval.

The compensation committee may amend the terms of any award granted under the 2009 equity incentive plan, prospectively or retroactively, but generally may not impair the rights of any participant without his or her consent.

Stockholder Approval of Equity Compensation Plans

The following table presents certain information about our equity compensation plans as of December 31, 2009:

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Equity Based Share Awards	Weighted-Average Exercise Price of Outstanding Equity Based Share Swards	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in the First Column of this Table)
Equity compensation plans approved by stockholders	22,159	$ 9.59	177,841
Equity compensation plans not approved by stockholders			
Total	22,159	$ 9.59	177,841

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OUR MANAGER AND THE MANAGEMENT AGREEMENT

Management Agreement With PRCM Advisers LLC

We have entered into a management agreement with PRCM Advisers LLC pursuant to which PRCM Advisers LLC provides for the day-to-day management of our operations.

The management agreement requires PRCM Advisers LLC to manage our business affairs in conformity with the investment guidelines and other policies that are approved and monitored by our board of directors. PRCM Advisers LLC s role as manager is under the supervision and direction of our board of directors. PRCM Advisers LLC is responsible for (i) the selection, purchase and sale of our portfolio investments, (ii) our financing activities, and (iii) providing us with investment advisory services. PRCM Advisers LLC is responsible for our day-to-day operations and performs (or causes to be performed) such services and activities relating to our assets and operations as may be appropriate, which may include the following:

serving as our consultant with respect to the periodic review of the investment guidelines and other parameters for our investments, financing activities and operations, any modification to which will be approved by a majority of our independent directors;
investigating, analyzing and selecting possible investment opportunities and acquiring, financing, retaining, selling, restructuring or disposing of investments consistent with the investment guidelines;
with respect to prospective purchases, sales or exchanges of investments, conducting negotiations on our behalf with sellers, purchasers and brokers and, if applicable, their respective agents and representatives;
negotiating and entering into, on our behalf, repurchase agreements, credit finance agreements, securitizations, agreements relating to borrowings under programs established by the U.S. government, commercial papers, interest rate swap agreements and other hedging instruments, warehouse facilities and all other agreements and engagements required for us to conduct our business;
engaging and supervising, on our behalf and at our expense, independent contractors which provide investment banking, securities brokerage, mortgage brokerage, other financial services, due diligence services, underwriting review services, legal and accounting services, and all other services as may be required relating to our investments;
coordinating and managing operations of any joint venture or co-investment interests held by us and conducting all matters with the joint venture or co-investment partners;
providing executive and administrative personnel, office space and office services required in rendering services to us;
administering the day-to-day operations and performing and supervising the performance of such other administrative functions necessary to our management as may be agreed upon by PRCM Advisers LLC and our board of directors, including the collection of revenues and the payment of our debts and obligations and maintenance of appropriate computer services to perform such administrative functions;
communicating on our behalf with the holders of any of our equity or debt securities as required to satisfy the reporting and other requirements of any governmental bodies or agencies or trading markets and to maintain effective relations with such holders;
counseling us in connection with policy decisions to be made by our board of directors;
evaluating and recommending to our board of directors hedging strategies and engaging in hedging activities on our behalf, consistent with such strategies as so modified from time to time, with our qualification as a REIT and with the investment guidelines;

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counseling us regarding the maintenance of our qualification as a REIT and monitoring compliance with the various REIT qualification tests and other rules set out in the Code and Treasury Regulations thereunder and using commercially reasonable efforts to cause us to qualify for taxation as a REIT;
counseling us regarding the maintenance of our exemption from the status of an investment company required to register under the 1940 Act, monitoring compliance with the requirements for maintaining such exemption and using commercially reasonable efforts to cause us to maintain such exemption from such status;
assisting us in developing criteria for asset purchase commitments that are specifically tailored to our investment objectives and making available to us its knowledge and experience with respect to mortgage-backed securities, mortgage loans, real estate, real estate-related securities and loans, other real estate-related assets and non-real estate-related assets;
furnishing reports and statistical and economic research to us regarding our activities and services performed for us by PRCM Advisers LLC;
monitoring the operating performance of our investments and providing periodic reports with respect thereto to the board of directors, including comparative information with respect to such operating performance and budgeted or projected operating results;
investing and reinvesting any moneys and securities of ours (including investing in short-term investments pending investment in other investments, payment of fees, costs and expenses, or payments of dividends or distributions to our stockholders and partners) and advising us as to our capital structure and capital raising;
causing us to retain qualified accountants and legal counsel, as applicable, to assist in developing appropriate accounting procedures and systems, internal controls and other compliance procedures and testing systems with respect to financial reporting obligations and compliance with the provisions of the Code applicable to REITs and to conduct quarterly compliance reviews with respect thereto;
assisting us in qualifying to do business in all applicable jurisdictions and to obtain and maintain all appropriate licenses;
assisting us in complying with all regulatory requirements applicable to us in respect of our business activities, including preparing or causing to be prepared all financial statements required under applicable regulations and contractual undertakings and all reports and documents, if any, required under the Exchange Act or the Securities Act, or by the NYSE Amex;
assisting us in taking all necessary action to enable us to make required tax filings and reports, including soliciting stockholders for required information to the extent required by the provisions of the Code applicable to REITs;
placing, or arranging for the placement of, all orders pursuant to PRCM Advisers LLC s investment determinations for us either directly with the issuer or with a broker or dealer (including any affiliated broker or dealer);
handling and resolving all claims, disputes or controversies (including all litigation, arbitration, settlement or other proceedings or negotiations) in which we may be involved or to which we may be subject arising out of our day-to-day operations (other than with PRCM Advisers LLC of its affiliates), subject to such limitations or parameters as may be imposed from time to time by the board of directors;
using commercially reasonable efforts to cause expenses incurred by us or on our behalf to be commercially reasonable or commercially customary and within any budgeted parameters or expense guidelines set by the board of directors from time to time;

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representing and making recommendations to us in connection with the purchase and finance of, and commitment to purchase and finance, mortgage-backed securities, mortgage loans (including on a portfolio basis), real estate, real estate-related securities and loans, other real estate-related assets and non-real estate-related assets, and the sale and commitment to sell such assets;

advising us with respect to obtaining appropriate repurchase agreements, warehouse facilities or other secured and unsecured forms of borrowing for our assets;

advising us with respect to preparing, negotiating and entering into, on our behalf, applications and agreements relating to programs established by the U.S. government;

advising us with respect to and structuring long-term financing vehicles for our portfolio of assets, and offering and selling securities publicly or privately in connection with any such structured financing;

performing such other services as may be required from time to time for management and other activities relating to our assets and business as our board of directors shall reasonably request or PRCM Advisers LLC shall deem appropriate under the particular circumstances; and

using commercially reasonable efforts to cause us to comply with all applicable laws.

Pursuant to the management agreement, PRCM Advisers LLC does not assume any responsibility other than to render the services called for thereunder and is not responsible for any action of our board of directors in following or declining to follow its advice or recommendations. PRCM Advisers LLC maintains a contractual as opposed to a fiduciary relationship with us; however, to the extent that employees or partners of PRCM Advisers LLC or its affiliates also serve as our directors, such directors owe us duties under Maryland law in their capacities as our directors, including the duty to act in good faith, in our best interests and with the care of an ordinarily prudent person in like position under similar circumstances, and, to the extent that employees or partners of PRCM Advisers LLC or its affiliates also serve as our officers, such officers owe us duties under Maryland law in their capacity as our officers, including generally the duty to exercise reasonable care in the performance of such officers responsibilities, as well as the duties of loyalty, good faith and candid disclosure. Under the terms of the management agreement, PRCM Advisers LLC, CLA Founders LLC, their respective officers, stockholders, members, managers, personnel, directors, any person controlling or controlled by PRCM Advisers LLC or CLA Founders LLC and any person providing sub-advisory services to PRCM Advisers LLC, CLA Founders LLC and their respective officers, stockholders, members, managers, personnel, directors, any person controlling or controlled by PRCM Advisers LLC of CLA Founders LLC are not liable to us, any subsidiary of ours, our directors, our stockholders, members or partners or any subsidiary s stockholders, members or partners for acts or omissions performed in accordance with or pursuant to the management agreement, except because of acts constituting reckless disregard of PRCM Advisers LLC s duties under the management agreement which have a material adverse effect on us or our subsidiaries, willful misconduct or gross negligence, as determined by a final non-appealable order of a court of competent jurisdiction. We have agreed to indemnify PRCM Advisers LLC, CLA Founders LLC, their respective officers, stockholders, directors, members, personnel, any person controlling or controlled by PRCM Advisers LLC or CLA Founders LLC and any other person providing sub-advisory services to PRCM Advisers LLC, together with the managers, officers, directors and personnel of PRCM Advisers LLC, CLA Founders LLC and their respective officers, members, directors, managers and personnel, with respect to all expenses, losses, damages, liabilities, demands, charges and claims arising from acts or omissions of such indemnified parties not constituting reckless disregard of PRCM Advisers LLC s duties under the management agreement which have a material adverse effect on us, willful misconduct or gross negligence. PRCM Advisers LLC has agreed to indemnify us, our directors and our officers with respect to all expenses, losses, damages, liabilities, demands, charges and claims arising from PRCM Advisers LLC s reckless disregard of PRCM Advisers LLC s duties under the management agreement which has a material adverse effect on us, willful misconduct or gross negligence. For the avoidance of doubt, PRCM Advisers LLC will not be liable for trade errors that may result from ordinary negligence, such as errors in the investment decision making process (*e.g.*, a transaction was effected in violation of our investment guidelines) or in the trade process (*e.g.*, a buy order was entered instead of a sell order, or the wrong security was purchased or sold, or a security was purchased or sold in an amount or at a price other than the correct amount or price).

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Pursuant to the management agreement, PRCM Advisers LLC is required to provide us with our management team, including a chief executive officer, president, chief financial officer and chief investment officer, along with appropriate support personnel, to provide the management services to be provided by PRCM Advisers LLC to us.

The management agreement may be amended or modified by agreement between us and PRCM Advisers LLC. The initial term of the management agreement expires on October 28, 2012 and the management agreement will be automatically renewed for a one-year term on such date and on each anniversary date thereafter unless previously terminated as described below. Our independent directors review PRCM Advisers LLC s performance and the management fees annually. Following the initial term, the management agreement may be terminated annually without cause upon the vote of at least two-thirds of our independent directors or by a vote of the holders of a majority of the outstanding shares of our common stock, based upon (1) unsatisfactory performance that is materially detrimental to us or (2) our determination that the management fees payable to PRCM Advisers LLC are not fair, subject to PRCM Advisers LLC s right to prevent such termination due to unfair fees by accepting a reduction of management fees agreed to by at least two-thirds of our independent directors. We must provide 180 days prior notice of any such termination. Unless terminated for cause, we will pay a termination fee to PRCM Advisers LLC equal to three times the sum of the average annual management fee during the 24-month period immediately preceding such termination, calculated as of the end of the most recently completed fiscal quarter before the date of termination (the termination fee).

We may also terminate the management agreement, without the payment of any termination fee, with 30 days prior written notice from us to PRCM Advisers LLC for cause, which is defined as:

PRCM Advisers LLC s continued material breach of any provision of the management agreement that has a material adverse effect on us following a period of 30 days after written notice thereof (or 90 days after written notice of such breach if PRCM Advisers LLC, under certain circumstances, has taken steps to cure such breach within 30 days of the written notice);

PRCM Advisers LLC s fraud, misappropriation of funds, or embezzlement against us;

PRCM Advisers LLC s gross negligence of duties under the management agreement;

the occurrence of certain events with respect to the bankruptcy or insolvency of PRCM Advisers LLC, including an order for relief in an involuntary bankruptcy case or PRCM Advisers LLC authorizing or filing a voluntary bankruptcy petition;

PRCM Advisers LLC is convicted (including a plea of *nolo contendere*) of a felony; and

the dissolution of PRCM Advisers LLC.

PRCM Advisers LLC may generally only assign the management agreement with the written approval of a majority of our independent directors. PRCM Advisers LLC, however, may assign the management agreement to Pine River or any of its affiliates without the approval of our independent directors.

PRCM Advisers LLC may terminate the management agreement if we become required to register as an investment company under the 1940 Act, with such termination deemed to occur immediately before such event, in which case we would not be required to pay a termination fee. PRCM Advisers LLC may decline to renew the management agreement by providing us with 180 days written notice, in which case we also would not be required to pay a termination fee. In addition, if we default in the performance of any material term of the agreement and the default continues for a period of 30 days after written notice to us, PRCM Advisers LLC may terminate the management agreement upon 60 days written notice. If the management agreement is terminated by PRCM Advisers LLC due to our material breach of such agreement, we would be required to pay the termination fee described above.

PRCM Advisers LLC s Management Fees, Expense Reimbursements, Termination Fee and Incentive Plan Compensation

We do not maintain an office or employ personnel. Instead we rely on the facilities and resources of PRCM Advisers LLC to conduct our operations. Expense reimbursements to PRCM Advisers LLC are made in cash on a quarterly basis following the end of each quarter.

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Base Management Fee

We pay PRCM Advisers LLC a management fee in an amount equal to 1.5% per annum, calculated and payable quarterly in arrears, of our stockholders equity. There is no incentive or performance based component of PRCM Advisers LLC s compensation.

For purposes of calculating the management fee, our stockholders equity means the sum of the net proceeds from all issuances of our equity securities since inception (allocated on a *pro rata* daily basis for such issuances during the fiscal quarter of any such issuance), plus our retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount that we pay for repurchases or our common stock since inception, and excluding any unrealized gains, losses or other items that do not affect realized net income (regardless of whether such items are included in other comprehensive income or loss, or in net income). This amount will be adjusted to exclude one-time events pursuant to changes in GAAP, and certain non-cash items after discussions between PRCM Advisers LLC and our independent directors and approval by a majority of our independent directors. To the extent asset impairments reduce our retained earnings at the end of any completed calendar quarter, we will reduce the management fee for such quarter. Our stockholders equity for the purposes of calculating the management fee could be greater than the amount of stockholders equity shown on the consolidated financial statements.

We treat issuances of limited liability company interests of our Subsidiary LLC, other than to us, as equity securities for purposes of calculating the management fee. PRCM Advisers LLC uses the proceeds from its management fee in part to pay compensation to officers and personnel who, notwithstanding that certain of them also are our officers, receive no cash compensation directly from us.

The management fee of PRCM Advisers LLC is calculated within 30 days after the end of each quarter and such calculation shall be promptly delivered to our board of directors. We are obligated to pay the management fee in cash within five business days after delivery to us of the written statement of PRCM Advisers LLC setting forth the computation of the management fee for such quarter.

Reimbursement of Expenses

Because PRCM Advisers LLC s personnel perform certain legal, accounting, due diligence tasks and other services that outside professionals or outside consultants otherwise would perform, PRCM Advisers LLC is paid or reimbursed for the documented cost of performing such tasks; *provided*, that such costs and reimbursements are in amounts which are no greater than those which would be payable to outside professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arm s-length basis.

We also pay all operating expenses, except those specifically required to be borne by PRCM Advisers LLC under the management agreement. The expenses required to be paid by us include:

expenses in connection with the issuance and transaction costs incident to the acquisition, disposition and financing of our investments;
costs of legal, tax, accounting, consulting, auditing, administrative and other similar services rendered for us by providers retained by PRCM Advisers LLC or, if provided by PRCM Advisers LLC s personnel, in amounts which are no greater than those which would be payable to outside professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arm s-length basis;

the compensation and expenses of our directors and the cost of liability insurance to indemnify our directors and officers;

costs associated with the establishment and maintenance of any of our or any subsidiary s repurchase agreements, warehouse facilities and other secured and unsecured forms of borrowings (including commitment fees, accounting fees, legal fees, closing and other similar costs) or any of our or any subsidiary s securities offerings;

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expenses in connection with the application for, and participation in, programs established by the U.S. government;
expenses connected with communications to holders of our securities or of our subsidiaries and other bookkeeping and clerical work necessary in maintaining relations with holders of such securities and in complying with the continuous reporting and other requirements of governmental bodies or agencies, including all costs of preparing and filing required reports with the SEC, the costs payable by us to any transfer agent and registrar in connection with the listing and/or trading of our stock on any exchange, the fees payable by us to any such exchange in connection with its listing, and costs of preparing, printing and mailing our annual report to our stockholders and proxy materials with respect to any meeting of our stockholders;
costs associated with any computer software or hardware, electronic equipment or purchased information technology services from third-party vendors that is used for us and our subsidiaries;
expenses incurred by managers, officers, personnel and agents of PRCM Advisers LLC for travel or entertainment on our behalf and other out-of-pocket expenses incurred by managers, officers, personnel and agents of PRCM Advisers LLC in connection with the purchase, financing, refinancing, sale or other disposition of an investment or establishment and maintenance of any of our repurchase agreements, warehouse facilities, borrowings under programs established by the U.S. government and other secured and unsecured forms of borrowings or any of our or any subsidiary s securities offerings;
costs and expenses incurred with respect to market information systems and publications, research publications and materials, including financial analytics and market data, and settlement, clearing and custodial fees and expenses;
compensation and expenses of our custodian and transfer agent, if any;
the costs of maintaining compliance with all federal, state and local rules and regulations or any regulatory agency;
all taxes and license fees;
all insurance costs incurred in connection with the operation of our business except for the costs attributable to the insurance that PRCM Advisers LLC elects to carry for itself and its personnel; *provided*, *however*, that we will be responsible for our *pro rata* portion of the premiums related to PRCM Advisers LLC s errors and omissions insurance coverage, as provided below;
costs and expenses incurred in contracting with third parties, including affiliates of PRCM Advisers LLC, for the servicing and special servicing of our assets;
all other costs and expenses relating to our business and investment operations, including the costs and expenses of acquiring, owning, protecting, maintaining, developing and disposing of investments, including appraisal, valuation, reporting, audit and legal fees;
expenses relating to any office(s) or office facilities, including disaster backup recovery sites and facilities, maintained for us or our investments separate from the office or offices of PRCM Advisers LLC;
expenses connected with the payments of interest, dividends or distributions in cash or any other form authorized or caused to be made by our board of directors to or on account of holders of our securities or of our subsidiaries, including in connection with any dividend reinvestment plan;
any judgment or settlement of pending or threatened proceedings (whether civil, criminal or otherwise) against us or any of our subsidiaries, or against any of our trustees, directors or officers or of any of our subsidiaries in its capacity as such for which we or any of our subsidiaries are required to indemnify such trustee, director or officer by any court or governmental agency;

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all other expenses actually incurred by PRCM Advisers LLC which are reasonably necessary for the performance by PRCM Advisers LLC of its duties and functions under the management agreement; and

any costs and expenses (including those described above) incurred by a sub-adviser engaged by PRCM Advisers LLC pursuant to Section 2(e) of the management agreement in connection with the provision of sub-advisory services in respect of PRCM Advisers LLC, including such costs and expenses of CLA Founders LLC; *provided*, *however*, that the reimbursement of any such costs and expenses shall be subject to the same limitations set forth in the management agreement on the reimbursement of the costs and expenses of PRCM Advisers LLC.

We have no obligation to reimburse PRCM Advisers LLC for the salary, bonus, benefit and other compensation costs of the personnel of PRCM Advisers LLC and its affiliates who provide services to us under the management agreement, except that we reimburse PRCM Advisers LLC for, without duplication, (i) in the event PRCM Advisers LLC were to hire its own personnel, our allocable share of the compensation paid by PRCM Advisers LLC to its personnel serving as our principal financial officer and general counsel and personnel employed by PRCM Advisers LLC as in-house legal, tax, accounting, consulting, auditing, administrative, information technology, valuation, computer programming and development and back-office resources to us, and (ii) any amounts for personnel of PRCM Advisers LLC s affiliates arising under the shared facilities and services agreement between PRCM Advisers LLC and Pine River, which is described further below under the section entitled *Shared Facilities and Services Agreement with Pine River*. Our share of such out-of-pocket costs is based upon commercially reasonable estimates of the percentage of time devoted by such personnel of PRCM Advisers LLC and its affiliates to our affairs. PRCM Advisers LLC must provide us with such information as we may reasonably request to support the determination of our share of such costs. PRCM Advisers LLC is responsible for the compensation paid by PRCM Advisers LLC to personnel serving as our Chief Executive Officer, President, and Chief Investment Officer and PRCM Advisers LLC s investment professionals.

In addition, we are required to pay our *pro rata* portion of (i) rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses of PRCM Advisers LLC and its affiliates required for our operations and (ii) premiums related to the errors and omissions insurance required to be maintained by PRCM Advisers LLC. These expenses will be allocated between PRCM Advisers LLC and us based on the ratio of our proportion of net assets compared to all remaining net assets managed or held by Pine River or managed by PRCM Advisers LLC as calculated at each quarter end. We and PRCM Advisers LLC will modify this allocation methodology, subject to our independent directors approval if the allocation becomes inequitable.

Termination Fee