MALASKI JAMES I
Form 144
November 17, 2003

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

FORM 144

NOTICE OF PROPOSED SALE OF SECURITIES
PURSUANT TO RULE 144 UNDER THE SECURITIES ACT OF 1933

ATTENTION: *Transmit for filing 3 Copies of this form concurrently with either placing an order with a broker to execute sale or executing a sale directly with a market maker.*

1*(a)* NAME OF ISSUER *(Please type or print)*	*(b)* IRS IDENT. NO.	*(c)* S.E.C. FILE NO.
Alpena Bancshares, Inc.	38-3567362	0001128227

1*(d)* ADDRESS OF ISSUER	STREET	CITY	STATE	ZIP CODE	*(e)* TELEPHONE NO.

AREA CODENUMBER 100 S. Second AvenueAlpenaMI49707989356-9041

2*(a)* NAME OF PERSON FOR WHOSE ACCOUNT THE SECURITIES ARE TO BE SOLD	*(b)* IRS IDENT. NO.	*(c)* RELATIONSHIP TO ISSUER	*(d)* ADDRESS	STREET	CITY	STATE	ZIP CODE
James I. Malaski	381-54-6671	Senior Officer	100	S. Second Avenue	Alpena	MI	49707

INSTRUCTION: The person filing this notice should contact the issuer to obtain the I.R.S. Identification Number and the S.E.C. File Number.

3*(a)* Title of the Class of Securities To Be Sold	*(b)* Name and Address of Each Broker Through Whom the Securities are to be Offered or Each Market Maker who is Acquiring the Securities	SEC USE ONLY Broker-Dealer File Number	*(c)* Number of Shares or Other Units To Be Sold *(See instr. 3(c))*	*(d)* Aggregate Market Value *(See instr. 3(d))*
Common Stock, par value $1.00 per share	Edward Jones, 3300 W. Washington Ave., Suite 11 Alpena, MI 49707		5238	125712

(e) Number of Shares or Other Units Outstanding *(See instr. 3(e))*	*(f)* Approximate Date of Sale *(See instr. 3(f))* (MO. DAY YR.)	*(g)* Name of Each Securities Exchange *(See instr. 3(g))*
1657480	11/21/2003	Over-The-Counter Bulletin Board

INSTRUCTIONS:

1. (a) Name of issuer
(b)Issuer s I.R.S. Identification Number
(c)Issuer s S.E.C. file number, if any (d)Issuer s address, including zip code
(e)Issuer s telephone number, including area code 2.
(a)Name of person for whose account the securities are to be sold
(b)Such person s I.R.S. identification number, if such a person is an entity
(c)Such person s relationship to the issuer (e.g., officer, director, 10%

stockholder,
or member of
immediate
family of any
of the
foregoing)
(d)Such
person s
address,
including zip
code 3.
(a)Title of the
class of
securities to
be sold
(b)Name and
address of
each broker
through
whom the
securities are
intended to be
sold
(c)Number of
shares or
other units to
be sold (if
debt
securities,
give the
aggregate
face amount)
(d)Aggregate
market value
of the
securities to
be sold as of a
specified date
within
10 days prior
to the filing
of this notice
(e)Number of
shares or
other units of
the class
outstanding,
or if debt
securities the
face amount
thereof
outstanding,
as shown by
the most
recent report
or statement
published by
the issuer
(f)Approximate
date on which
the securities
are to be sold

(g)Name of each securities exchange, if any, on which the securities are intended to be sold

Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.	OVER SEC 1147 (10-00)

TABLE I SECURITIES TO BE SOLD

Furnish the following information with respect to the acquisition of the securities to be sold and with respect to the payment of all or any part of the purchase price or other consideration therefor:

Title of the Class	Date you Acquired	Nature of Acquisition Transaction	Name of Person from Whom Acquired (If gift, also give date donor acquired)	Amount of Securities Acquired	Date of Payment	Nature of Payment
Common Stock, par value $1.00 per share	11/4/1994	Initial Purchase Offer	First Federal Savings and Loan Association of Alpena	3500	11/4/1994	Cash on acquisition date
Common Stock, par value $1.00 per share	6/11/1997	Shares awarded through 1996 Recognition and Retention Plan	First Federal Savings and Loan Association of Alpena	340	No payment due to being awarded shares	Award
Common Stock, par value $1.00 per share	6/11/1998	Shares awarded through 1996 Recognition and Retention Plan	First Federal Savings and Loan Association of Alpena	340	No payment due to being awarded shares	Award
Common Stock, par value $1.00 per share	6/11/1999	Shares awarded through 1996 Recognition and Retention Plan	First Federal Savings and Loan Association of Alpena	340	No payment due to being awarded shares	Award
Common Stock, par value $1.00 per share	6/11/2000	Shares awarded through 1996 Recognition and Retention Plan	First Federal Savings and Loan Association of Alpena	340	No payment due to being awarded shares	Award
Common Stock, par value $1.00 per share	6/11/2001	Shares awarded through 1996 Recognition and Retention Plan	First Federal of Northern Michigan f/k/a First Federal Savings and Loan Association of Alpena	340	No payment due to being awarded shares	Award
Common Stock, par value $1.00 per share	3/27/2002	Shares awarded through 1996 Recognition and Retention Plan	First Federal of Northern Michigan f/k/a First Federal Savings and Loan Association of Alpena	38	No payment due to being awarded shares	Award

INSTRUCTIONS:

1. If the securities were purchased and full payment therefor was not made in cash at the time of purchase, explain in the table or in a note thereto the nature of the consideration given. If the consideration consisted of any note or other obligation, or if payment was made in installments describe the arrangement and state when the note or other obligation was discharged in full or the last

installment paid.

2. If within two years after the acquisition of the securities the person for whose account they are to be sold had any short positions, put or other option to dispose of securities referred to in paragraph (d)(3) of Rule 144, furnish full information with respect thereto.

TABLE II SECURITIES SOLD DURING THE PAST 3 MONTHS

Furnish the following information as to all securities of the issuer sold during the past 3 months by the person for whose account the securities are to be sold.

Name and Address of Seller	Title of Securities Sold	Date of Sale	Amount of Securities Sold	Gross Proceeds

REMARKS:

INSTRUCTIONS:

See the definition of person in paragraph (a) of Rule 144. Information is to be given not only as to the person for whose account the securities are to be sold but also as to all other persons included in that definition. In addition, information shall be given as to sales by all persons whose sales are required by paragraph (e) of Rule 144 to be aggregated with sales for the account of the person filing this notice.

11/17/2003

DATE OF NOTICE

ATTENTION:

The person for whose account the securities to which this notice relates are to be sold hereby represents by signing this notice that he does not know any material adverse information in regard to the current and prospective operations of the Issuer of the securities to be sold which has not been publicly disclosed.

/s/ James I. Malaski

(SIGNATURE)

The notice shall be signed by the person for whose account the securities are to be sold. At least one copy of the notice shall be manually signed. Any copies not manually signed shall bear typed or printed signatures.

ATTENTION: Intentional misstatements or omission of facts constitute Federal Criminal Violations (See 18 U.S.C. 1001)

style="vertical-align:bottom;border-bottom:1px solid #000000;padding-left:2px;padding-top:2px;padding-bottom:2px;background-color:#cceeff;">

$
42,614

$
100.00

$
42,614

$
100.00

$
13,650

$
13,650

$
100.00

$
13,650

$
100.00

Total Net Investments

$
928,782

$
860,301

$
766,465

$
720,755

(1) Represents the dollar amount (not shown in thousands) per $100 of current principal of the price or cost for the security.
(2) Excludes Interest Only, Principal Only, and Other Private Label securities.
(3) Excludes equity tranches and similar securities.
(4) Excludes Interest Only securities and TBAs.

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The following table summarizes our financial derivatives portfolio as of March 31, 2013 and December 31, 2012. For more detailed information about the investments in our portfolio, please refer to the Consolidated Condensed Schedule of Investments as of these dates contained in our consolidated financial statements.

	March 31, 2013		December 31, 2012	
(In thousands)	Notional Value	Fair Value	Notional Value	Fair Value
Long Mortgage-Related Derivatives: (1)				
CDS on RMBS and CMBS Indices	$39,935	$(14,092)	$40,216	$(11,986)
Total Long Mortgage-Related Derivatives	39,935	(14,092)	40,216	(11,986)
Short Mortgage-Related Derivatives: (2)				
CDS on RMBS and CMBS Indices	(57,451)	9,329	(74,621)	10,986
CDS on Individual RMBS	(37,262)	26,396	(45,121)	36,030
Total Short Mortgage-Related Derivatives	(94,713)	35,725	(119,742)	47,016
Net Mortgage-Related Derivatives	$(54,778)	$21,633	$(79,526)	$35,030
Short CDS on Corporate Bond Indices	$(85,500)	$(2,759)	$(67,500)	$(484)
Long Total Return Swaps on Corporate Equities (5)	$2,440	$(13)	$—	$—
Short Total Return Swaps on Corporate Equities (5)	$(13,571)	$47	$(18,737)	$(65)
Interest Rate Derivatives:				
Long Interest Rate Swaps (3)	$17,280	$(17)	$2,500	$(32)
Short Interest Rate Swaps (4)	(548,070)	(1,083)	(238,900)	(1,087)
Short Eurodollar Futures (6)	(42,000)	(48)	(63,000)	(70)
Total Net Interest Rate Derivatives	$(572,790)	$(1,148)	$(299,400)	$(1,189)
Total Net Derivatives	$(724,199)	$17,760	$(465,163)	$33,292

(1) Long mortgage-related derivatives represent transactions where the Company sold credit protection to a counterparty.
(2) Short mortgage-related derivatives represent transactions where the Company purchased credit protection from a counterparty.
(3) For long interest rate swaps, a floating rate is being paid and a fixed rate is being received.
(4) For short interest rate swaps, a fixed rate is being paid and a floating rate is being received.
(5) Notional value represents number of underlying shares or par value times the closing price of the underlying security.
(6) Every $1,000,000 in notional value represents one contract.

As of March 31, 2013, our Consolidated Statement of Assets, Liabilities, and Equity reflects total assets of $2.3 billion as compared to $2.2 billion as of December 31, 2012. Total liabilities as of March 31, 2013 were $1.8 billion as compared to $1.6 billion as of December 31, 2012. Our portfolios of investments and financial derivatives included in total assets totaled $1.6 billion and $1.4 billion as of March 31, 2013 and December 31, 2012, respectively, while our investments sold short and financial derivatives included in total liabilities were $668.2 million and $637.5 million as of March 31, 2013 and December 31, 2012, respectively. We use TBAs in combination with interest rate swaps as the primary instruments to hedge interest rate risk in our long Agency RMBS portfolio. On a quarterly basis, outstanding amounts of these hedging instruments may fluctuate according to the size of our long Agency RMBS portfolio as well as according to how we view market dynamics as favoring the use of one or the other.

TBA-related assets include TBAs and receivables for TBAs sold short, and TBA-related liabilities include TBAs sold short and payables for TBAs purchased. As of March 31, 2013, total assets included $90.0 million of TBAs as well as

$606.3 million of receivable for securities sold relating to unsettled TBA sales. As of December 31, 2012, total assets included $43.6 million of TBAs as well as $608.5 million of receivable for securities sold relating to unsettled TBA sales. As of March 31, 2013, total liabilities included $607.3 million of TBAs sold short as well as $89.9 million of payable for securities purchased relating to unsettled TBA purchases. As of December 31, 2012, total liabilities included $608.7 million of TBAs sold short as well as $43.8 million of payable for securities purchased relating to unsettled TBA purchases. Open TBA purchases and sales involving the same counterparty, the same underlying deliverable Agency pass-throughs, and the same settlement date are reflected in our consolidated financial statements on a net basis.

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As of March 31, 2013 and December 31, 2012, our net short TBAs (short TBA positions reduced by long TBA positions) was $517.3 million and $565.1 million, respectively. The aggregate value of our other (i.e. non-TBA) Agency RMBS as of March 31, 2013 and December 31, 2012, was $861.0 million and $774.3 million, respectively. We increased our non-TBA Agency RMBS long position following the recent volatility in Agency RMBS prices and the resulting opportunities in that market. Our net Agency RMBS position (long non-TBA Agency RMBS reduced by net short TBAs) increased to a long position of $343.7 million as of March 31, 2013 from a long position of $209.2 million as of December 31, 2012. As of March 31, 2013, we reduced our net short TBAs relative to our long Agency RMBS, in favor of increased net short interest rate swaps. Since we actively trade our Agency RMBS, our gross positions tend to fluctuate significantly from period to period. In addition we continuously re-evaluate our overall net Agency RMBS position.

As of March 31, 2013, we held $584.9 million of non-Agency MBS, other ABS, and commercial mortgage loans as compared to $557.2 million as of December 31, 2012. The increase in the total value of our non-Agency MBS portfolio is due in part to the extension of the rally in non-Agency asset valuations that began in early 2012 and in part to the active trading of the portfolio whereby we profitably sold lower dollar priced securities and purchased a greater amount of higher priced securities. The non-Agency MBS market over the past year has been fueled by the apparent recovery in the U.S. housing market as well as the increased demand for higher yielding fixed income assets. Throughout this rally, we have rotated out of certain assets that we believed had become more fully valued, and into other non-Agency MBS assets whose prices had lagged in comparison. In our CMBS strategy, although we recently have had only a modest amount of our capital allocated to this sector, we have actively traded our holdings. During the quarter, we exited a CMBS position which had declined in value, thereby generating a realized loss for the period. However, this realized loss was offset by unrealized gains in our other holdings. As of March 31, 2013, our CMBS and commercial mortgage loan portfolio represented 3% of the fair value of our non-Agency portfolio as compared to 5% as of December 31, 2012. In addition, during the quarter we purchased our first CLO securities in the Consolidated Condensed Schedule of Investments. As of March 31, 2013, our CLOs represented 2% of the fair value of our non-Agency portfolio.

As of March 31, 2013, our holdings of net mortgage-related derivatives declined as compared to December 31, 2012. We use mortgage-related credit derivatives primarily to hedge credit risk in our non-Agency MBS portfolio, although we also may from time to time take net long positions in certain CDS on RMBS and CMBS indices. Our CDS on individual RMBS represent short positions whereby we have synthetically purchased credit protection on specific non-Agency RMBS bonds. The overall outstanding notional value of our short CDS contracts on individual RMBS declined to $37.3 million as of March 31, 2013 from $45.1 million as of December 31, 2012. Certain of these contracts ran off during the period, while others were deliberately terminated.

As of March 31, 2013, the net short notional value of our holdings of CDS on RMBS and CMBS indices was $17.5 million as compared to $34.4 million as of December 31, 2012. The period-over-period decline in our net short holdings of mortgage-related derivatives in part reflected our decision to hedge less of our credit risk, so as to more fully benefit from the rally in non-Agency MBS. At the same time, we increased our short position in CDS on corporate bond indices. As of March 31, 2013, our short CDS on corporate bond indices increased to a notional amount of $85.5 million from $67.5 million as of December 31, 2012. As market conditions change, especially as the pricing of various credit hedging instruments changes in relation to our outlook on future credit performance, we continuously re-evaluate both the extent to which we hedge credit risk and the particular mix of instruments that we use to hedge credit risk.

As of March 31, 2013, the notional value of our net short interest rate swaps increased to $530.8 million from $236.4 million as of December 31, 2012. This increase was related both to the increase in our Agency RMBS holdings as well as to our decision to replace a portion of our short TBA interest rate hedges with short interest rate swaps.

We have entered into reverse repos to finance some of our assets. As of March 31, 2013 and December 31, 2012, indebtedness outstanding on our reverse repos was approximately $965.3 million and $905.7 million, respectively. The increase in our outstanding indebtedness as of March 31, 2013 as compared to December 31, 2012 was principally the result of a larger portfolio of Agency RMBS held as of March 31, 2013 as compared to December 31, 2012 and a higher amount of financed non-Agency MBS as of March 31, 2013 as compared to December 31, 2012.

As of March 31, 2013, we had total Agency RMBS financed with reverse repos of $764.5 million as compared to $737.9 million as of December 31, 2012. As of March 31, 2013, we had total non-Agency MBS financed with reverse repos of $373.4 million as compared to $313.2 million as of December 31, 2012. Outstanding indebtedness under reverse repos for Agency RMBS as of March 31, 2013 and December 31, 2012 was $727.8 million and $704.9 million, respectively, while outstanding indebtedness under reverse repos for non-Agency MBS as of March 31, 2013 and December 31, 2012 was $237.5 million and $200.8 million, respectively. Our reverse repos bear interest at rates that have historically moved in close relationship to LIBOR. We account for our reverse repos as collateralized borrowings. See the discussion in "—Liquidity and Capital Resources" below for further information on our reverse repos.

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In connection with our derivative and TBA transactions, in certain circumstances we may require that counterparties post collateral with us. When we exit a derivative or TBA transaction for which a counterparty has posted collateral, we may be required to return some or all of the related collateral to the respective counterparty. As of March 31, 2013 and December 31, 2012, our derivative and/or TBA counterparties posted an aggregate value of approximately $21.6 million and $31.0 million, respectively as of each date, of collateral with us. This collateral posted with us is included in Due to brokers on margin accounts on our Consolidated Statement of Assets, Liabilities, and Equity.

TBA Market

We generally do not settle our purchases and sales of TBAs. If, for example, we wish to maintain a short position in a particular TBA as a hedge, we may "roll" the short TBA transaction. In a hypothetical roll transaction, we might have previously entered into a contract to sell a specified amount of 30-year FNMA 4.5% TBA pass-throughs to a particular counterparty for a specified settlement date. As this settlement date approaches, because we generally do not intend to settle the sale transaction, but we wish to maintain the short position, we enter into a roll transaction whereby we purchase the same amount of 30-year FNMA 4.5% TBA pass-throughs (but not necessarily from the same counterparty) for the same specified settlement date, and we sell the same amount of 30-year FNMA 4.5% TBA pass-throughs (potentially to yet another counterparty) for a later settlement date. In this way, we have essentially "flattened out" our 30-year FNMA 4.5% TBA pass-through position for the earlier settlement date (i.e., offset the original sale with a corresponding purchase), and established a new short position for the later settlement date, hence maintaining our short position. By rolling our transaction, we maintain our desired short position in 30-year FNMA 4.5% securities without settling the original sale transaction.

In the case where the counterparty from whom we purchase (or to whom we sell) for the earlier settlement date is the same as the counterparty to whom we sell (or from whom we purchase) for the later settlement date, and when these purchases/sales are transacted simultaneously, this pair of simultaneous purchases or sales is often referred to as a "TBA roll" transaction.

In some instances, to avoid taking or making delivery of TBA securities, we will "pair off" an open purchase or sale transaction with an offsetting sale or purchase with the same counterparty. Alternatively, we will "assign" open transactions from counterparties from whom we have purchased to other counterparties to whom we have sold. In either case, no securities are actually delivered, but instead the net difference in trade proceeds of the offsetting transactions is calculated and a money wire representing such difference is sent to the appropriate party.

For the three month period ended March 31, 2013, as disclosed on our Consolidated Statement of Cash Flows, the aggregate TBA activity, or volume of closed transactions based on the sum of the absolute value of buy and sell transactions, was $4.1 billion as compared to $4.2 billion for the three month period ended March 31, 2012. Our TBA activity has principally consisted of: (a) sales (respectively purchases) of TBAs as hedges in connection with purchases (respectively sales) of certain other RMBS assets (especially fixed rate Agency whole pools); (b) TBA roll transactions (as described above) effected to maintain existing TBA short positions; and (c) TBA "sector rotation" transactions whereby a short TBA position in one TBA security is replaced with a short position in a different TBA security. Since the Company has actively turned over its portfolio of fixed rate Agency whole pools, the volume of TBA hedging transactions has also been correspondingly high. Moreover, the Company’s fixed rate Agency whole pool portfolio is typically larger in gross size than the Company’s equity capital base, and so the Company tends to hold large short TBA positions relative to its equity capital base at any time. Finally, the entire amount of short TBA positions held at each monthly TBA settlement date is typically rolled to the following month, and since the amount of short TBA positions tends to be large relative to the Company’s equity capital base, TBA roll transaction volume over multi-month periods can represent a multiple of the Company’s equity capital base.

Equity

As of March 31, 2013, our equity increased by approximately $14.2 million to $520.6 million from $506.4 million as of December 31, 2012. This increase principally consisted of a net increase in equity resulting from operations for the three month period ended March 31, 2013 of approximately $40.7 million, an increase for contribution from non-controlling interest of approximately $4.7 million, and an increase for LTIP awards and common shares issued to our Manager in connection with incentive fee payment of approximately $0.8 million offset by a decrease for dividends paid of approximately $31.9 million. Shareholders' equity, which excludes the non-controlling interest

related to the minority interest in the Operating Partnership, was $515.8 million as of March 31, 2013.
As of December 31, 2012, our shareholders' equity increased by approximately $135.4 million from December 31, 2011. This increase principally consisted of net increase in shareholders' equity resulting from operations for the year ended December 31, 2012 of approximately $97.1 million, net proceeds from the issuance of shares of approximately $87.8 million (after all offering costs), a decrease for dividends paid of approximately $47.4 million, and a decrease for shares repurchased of approximately $3.4 million.

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Results of Operations for the Three Month Periods Ended March 31, 2013 and 2012

The table below represents the net increase in equity resulting from operations for the three month periods ended March 31, 2013 and 2012.

	Three Month Period Ended March 31,	
(In thousands except per share amounts)	2013	2012
Investment income—Interest income	$ 18,382	$ 15,733
Expenses:		
Base management fee	1,967	1,492
Incentive fee	2,055	—
Interest expense	2,142	1,832
Other operating expenses	1,649	1,449
Total expenses	7,813	4,773
Net investment income	10,569	10,960
Net realized and unrealized gain on investments	36,836	26,277
Net realized and unrealized loss on financial derivatives	(6,659)	(5,182)
Net increase in equity resulting from operations	$ 40,746	$ 32,055
Less: Net increase in equity resulting from operations attributable to non-controlling interest	$ 411	$ —
Net increase in shareholders' equity resulting from operations	$ 40,335	$ 32,055
Net increase in shareholders' equity resulting from operations per share	$ 1.94	$ 1.90

Results of Operations for the Three Month Periods Ended March 31, 2013 and 2012

Summary of Net Increase in Shareholders' Equity from Operations

Our net increase in shareholders' equity from operations ("net income") for the three month periods ended March 31, 2013 and 2012 was $40.3 million and $32.1 million, respectively. The increase in our net income period-over-period was primarily driven by an increase in net realized and unrealized gains in our non-Agency MBS strategy resulting from the continuing rally in non-Agency MBS during the period as supplemented by trading gains. The climate for non-Agency MBS assets has remained favorable as home prices have continued to improve and as fixed income investors continue to be attracted to the higher yields offered by the non-Agency MBS sector. Total return based on changes in "net asset value" or "book value" for our common shares was 7.9% for the three month period ended March 31, 2013 as compared to 8.7% for the three month period ended March 31, 2012. Despite the increase in net income for the three month period ended March 31, 2013 as compared to the three month period ended March 31, 2012, total return was lower in the current period as compared to the prior period, since the income earned in the current period was earned on a much higher capital base. Average shareholders' equity for the three months ended March 31, 2013 was $517.4 million as compared to $383.0 million for the comparable period of 2012. Total return on our common shares is calculated based on changes in net asset value per share or book value per share and assumes reinvestment of dividends.

Net Investment Income

Net investment income was $10.6 million for the three month period ended March 31, 2013 as compared to $11.0 million for the three month period ended March 31, 2012. Net investment income consists of interest income less total expenses. The period-over-period decrease in net investment income was due to higher expenses for the three month period ended March 31, 2013, primarily related to incentive fee expense incurred in the current period whereas no incentive fee expense was incurred in the prior period.

Interest Income

Interest income was $18.4 million for the three month period ended March 31, 2013 as compared to $15.7 million for the three month period ended March 31, 2012. Interest income includes coupon payments received and accrued on our holdings, the net accretion and amortization of purchased discounts and premiums on those holdings and interest on our cash balances, including those balances held by our counterparties as collateral. The increase in interest income period-over-period was driven mainly by an increase in interest income from our non-Agency MBS portfolio, which grew in size and yield. Interest income from Agency RMBS also increased, although not significantly. For the three

month period ended March 31, 2013, interest

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income from our non-Agency portfolios was $12.1 million while for the three month period ended March 31, 2012, interest income was $9.6 million. For the three month period ended March 31, 2013, interest income from our Agency RMBS was $6.3 million while for the three month period ended March 31, 2012, interest income was $6.1 million.

Base Management Fees

For the three month periods ended March 31, 2013 and 2012 base management fee incurred, which is based on total equity at the end of each quarter, was $2.0 million and $1.5 million, respectively. The increase in the base management fee was the result of the increase in equity, period-over-period, which resulted primarily from the completion of a public equity offering during the year ended December 31, 2012 (from which we received net proceeds of $87.8 million, after all offering costs), as well as from the recognition of net income in excess of dividends paid.

Interest Expense

Interest expense includes interest on funds borrowed under reverse repos, securitized debt, coupon interest on securities sold short, the related net accretion and amortization of purchased discounts and premiums on those short holdings, and interest on our counterparties' cash collateral held by us. We had average borrowed funds under reverse repos of $979.7 million and $888.9 million for the three month periods ended March 31, 2013 and 2012, respectively. Our total interest expense, inclusive of interest expense on securitized debt and our counterparties' cash collateral held by us, increased to $2.1 million for the three month period ended March 31, 2013 as compared to $1.8 million for the three month period ended March 31, 2012. Our total weighted average borrowing cost under our reverse repos was 0.80% for the three month period ended March 31, 2013 as compared to 0.78% for the three month period ended March 31, 2012. The period-over-period increase in our weighted average borrowing costs under reverse repos was primarily due to a 7 basis point period-over-period increase in our average cost of funds related to Agency RMBS. For the three month period ended March 31, 2013, 23.9% of our average borrowings under reverse repos were related to our non-Agency MBS holdings. For the three month period ended March 31, 2012, 26.0% of our average borrowings were related to our non-Agency MBS holdings.

The tables below show our average borrowed funds, interest expense, average cost of funds, average one-month LIBOR and average six-month LIBOR under our reverse repos for the three month periods ended March 31, 2013 and 2012.

Agency Securities

(In thousands)	Average Borrowed Funds	Interest Expense	Average Cost of Funds	Average One-Month LIBOR	Average Six-Month LIBOR
For the three month period ended March 31, 2013	$745,987	$779	0.42 %	0.20 %	0.47 %
For the three month period ended March 31, 2012	$657,354	$572	0.35 %	0.26 %	0.76 %

Non-Agency Securities

(In thousands)	Average Borrowed Funds	Interest Expense	Average Cost of Funds	Average One-Month LIBOR	Average Six-Month LIBOR
For the three month period ended March 31, 2013	$233,725	$1,164	2.02 %	0.20 %	0.47 %
For the three month period ended March 31, 2012	$231,496	$1,170	2.02 %	0.26 %	0.76 %

Agency and Non-Agency Securities

(In thousands)	Average Borrowed Funds	Interest Expense	Average Cost of Funds	Average One-Month LIBOR	Average Six-Month LIBOR
For the three month period ended March 31, 2013	$979,712	$1,943	0.80 %	0.20 %	0.47 %

For the three month period ended March 31, 2012	$ 888,850	$ 1,742	0.78 %	0.26 %	0.76 %

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Incentive Fees

In addition to the base management fee, our Manager is also entitled to a quarterly incentive fee if, and in proportion to the extent that, our performance (as measured by adjusted net income, as defined in the management agreement) over the relevant rolling four quarter calculation period exceeds a defined return hurdle for the period. Incentive fee incurred for the three month period ended March 31, 2013 was $2.1 million. No incentive fee was incurred for the three month period ended March 31, 2012. The return hurdle for each calculation period was based on a 9% annual rate.

Other Operating Expenses

Other operating expenses consist of professional fees, compensation expense related to our dedicated and partially dedicated personnel, share-based LTIP expense, insurance expense, and various other operating expenses necessary to run our business. Other operating expenses exclude interest expense. Other operating expenses for the three month period ended March 31, 2013 were $1.6 million as compared to $1.4 million for the three month period ended March 31, 2012.

Net Realized and Unrealized Gains on Investments

During the three month period ended March 31, 2013, we had net realized and unrealized gains on investments of $36.8 million as compared to net realized and unrealized gains of $26.3 million for the three month period ended March 31, 2012. Prices of non-Agency MBS increased during the three month period ended March 31, 2013 while Agency RMBS prices declined. Net realized and unrealized gains on investments of $36.8 million for the three month period ended March 31, 2013 resulted principally from net realized and unrealized gains on our non-Agency MBS, commercial mortgage loans, and TBAs, partially offset by net realized and unrealized losses on our Agency RMBS and other ABS. Our TBAs were held on a net short basis and were used primarily to hedge interest rate and prepayment risk with respect to our Agency RMBS. Net gains on our non-Agency MBS, commercial mortgage loans, other ABS, and TBAs were $42.4 million while net losses on our Agency RMBS were $5.6 million. Gains were particularly notable for our non-Agency RMBS, as that sector of the market extended its 2012 rally into the first quarter of 2013 in response to continued home price appreciation and improved delinquency and default statistics. Additionally, with Federal Reserve policy actions having pushed U.S. Treasury and Agency RMBS yields so low, fixed income investors continue to be attracted to the higher yields offered by the non-Agency MBS sector. In contrast, the market for Agency RMBS has experienced both upward and downward volatility in recent months, as uncertainty grows around future Federal Reserve actions, particularly as it relates to its asset purchase programs and the timing of the inevitable wind-down of such programs.

Net realized and unrealized gains on investments of $26.3 million for the three month period ended March 31, 2012 resulted principally from net realized and unrealized gains on our non-Agency MBS and Agency RMBS, partially offset by net realized and unrealized losses on our TBAs and U.S. Treasury securities.

Net Realized and Unrealized Losses on Financial Derivatives

During the three month period ended March 31, 2013, we had net realized and unrealized losses on our financial derivatives of $6.7 million as compared to net realized and unrealized losses of $5.2 million for the three month period ended March 31, 2012. Our financial derivatives consist of interest rate derivatives, which we use primarily to hedge interest rate risk, and of credit derivatives and total return swaps, both of which we use primarily to hedge credit risk, but also in some cases as a means to assume credit risk. Our interest rate derivatives are primarily in the form of short positions in interest rate swaps, and to a lesser extent short positions in Eurodollar futures. We also use certain non-derivative instruments, such as TBAs and U.S. Treasury securities, to hedge interest rate risk. Our credit hedges are primarily in the form of credit default swaps where we have purchased credit protection on non-Agency MBS, although from time to time our credit hedges also include total return swaps and CDS on corporate bond indices, which we use to take short positions in various corporate equity and debt securities. Net realized and unrealized losses of $6.7 million on our financial derivatives for the three month period ended March 31, 2013 resulted primarily from net losses of $7.1 million related to our credit hedges partially offset by net gains of $0.4 million related to our interest rate derivatives. The benchmark five-year swap rate increased during the three month period ending March 31, 2013 to 0.95% from 0.86% at December 31, 2012.

We recognized net realized and unrealized losses from our CDS on RMBS and CMBS indices in the amount of $0.9 million. We also recognized net realized and unrealized losses related to our CDS on individual RMBS in the amount of $2.4 million. Since these positions serve primarily as credit hedges for our long non-Agency MBS holdings, these losses were not unexpected given the price increases of credit-sensitive MBS during the year. We also recognized a loss of $3.8 million on CDS on corporate bond indices as corporate bonds rallied during the period. Our CDS on corporate bond indices also serve as hedges against our long non-Agency MBS holdings, although with somewhat less correlation than our CDS on RMBS and CMBS indices. These losses on credit hedges were partially offset by net realized and unrealized gains on our interest rate swaps in the amount of $0.4 million.

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Net realized and unrealized losses on our financial derivatives of $5.2 million for the three month period ended March 31, 2012 resulted principally from net realized and unrealized losses from our CDS on RMBS and CMBS indices, CDS on corporate indices, and total return swaps, partially offset by net realized and unrealized gains on our CDS on individual RMBS and interest rate swaps.

Liquidity and Capital Resources

Liquidity refers to our ability to meet our cash needs, including repaying our borrowings, funding and maintaining RMBS and other assets, making distributions in the form of dividends and other general business needs. Our short-term (one year or less) and long-term liquidity requirements include acquisition costs for assets we acquire, payment of our base management fee and incentive fee, compliance with margin requirements under our repo, reverse repo, TBA, and derivative contracts, repayment of reverse repo borrowings to the extent we are unable or unwilling to extend our reverse repos and payment of our general operating expenses. Our capital resources primarily include cash on hand, cash flow from our investments (including monthly principal and interest payments received on our MBS and proceeds from the sale of securities), borrowings under reverse repos and proceeds from equity offerings. We expect that these sources of funds will be sufficient to meet our short-term and long-term liquidity needs.

The following summarizes our reverse repos:

	Reverse Repurchase Agreements	
	Average Borrowed Funds During the Period	Borrowed Funds Outstanding at End of the Period
Three Month Period Ended March 31, 2013	$979,712	$965,272
Three Month Period Ended March 31, 2012	$888,850	$921,406

The following summarizes our borrowings under reverse repos by remaining maturity:

(In thousands)	As of March 31, 2013		
Remaining Days to Maturity	Outstanding Borrowings	%	
30 Days or Less	$241,554	25.0	%
31 - 60 Days	319,003	33.1	%
61 - 90 Days	49,420	5.1	%
91 - 120 Days	—	—	%
121 - 150 Days	109,152	11.3	%
151 - 180 Days	246,143	25.5	%
	$965,272	100.0	%

Reverse repos involving underlying investments that we sold prior to March 31, 2013, for settlement following March 31, 2013, are shown using their original maturity dates even though such reverse repos may be expected to be terminated early upon settlement of the sale of the underlying investment. Not included are any reverse repos that we may have entered into prior to March 31, 2013 for which delivery of the borrowed funds is not scheduled until after March 31, 2013.

We expect to continue to borrow funds in the form of reverse repos as well as other similar types of financings. The terms of these borrowings under our master repurchase agreements generally conform to the terms in the standard master repurchase agreement as published by the Securities Industry and Financial Markets Association or, "SIFMA," as to repayment and margin requirements. In addition, each lender typically requires that we include supplemental terms and conditions to the standard master repurchase agreement. Typical supplemental terms and conditions include the addition of or changes to provisions relating to margin calls, net asset value requirements, cross default provisions, certain key person events, changes in corporate structure, and requirements that all controversies related to the repurchase agreement be litigated in a particular jurisdiction. These provisions may differ for each of our lenders. We also have entered into an "evergreen" repurchase agreement with one lender that provides for an original term of 180 days, and which is automatically extended every day for an additional day (so as to maintain a remaining term of 180 days) unless notified otherwise by the lender. The agreement is not based on the SIFMA form but its terms and conditions are similar to the terms and conditions of our other repurchase agreements including with respect to events

of default and remedies upon default.

In January 2012, we completed a small resecuritization transaction that provided us with long-term financing for the asset

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subject to the resecuritization. The amount of financing (securitized debt) resulting from this transaction amounted to $1.5 million and the expected maturity is approximately four years. While we may from time to time use resecuritizations as a way to finance our assets, we expect the vast majority of our financing needs to continue to be met through the use of reverse repos.

As of March 31, 2013 and December 31, 2012, we had $965.3 million and $905.7 million, respectively of borrowings outstanding under our reverse repos. As of March 31, 2013, the remaining terms on our reverse repos ranged from 1 to 180 days, with an average remaining term of 81 days. As of December 31, 2012, the remaining terms on our reverse repos ranged from 10 to 180 days, with an average remaining term of 57 days. Our reverse repo borrowings were with a total of twelve counterparties as of March 31, 2013 and were with a total of ten counterparties as of December 31, 2012. As of March 31, 2013, we did not have an amount at risk under our reverse repos with any single counterparty that was greater than 10% of our equity. As of December 31, 2012 the amount at risk outstanding in connection with reverse repos with Wells Fargo Bank, N.A. was $50.8 million or 10.03% of equity. The weighted average maturity of the reverse repos with Wells Fargo Bank, N.A. was 180 days. Amount at risk represents the aggregate excess, if any, for each counterparty of the fair value of collateral held by such counterparty over the amounts outstanding under reverse repos. As of March 31, 2013 and December 31, 2012, our reverse repos had a weighted average borrowing rate of 0.82% and 0.77%, respectively. As of March 31, 2013, our reverse repos had interest rates ranging from 0.36% to 2.45%. As of December 31, 2012, our reverse repos had interest rates ranging from 0.37% to 2.31%. MBS pledged as collateral under the reverse repos had an aggregate estimated fair value of $1.1 billion as of both March 31, 2013 and December 31, 2012. The interest rates of our reverse repos have historically moved in close relationship to short-term LIBOR rates, and in some cases are explicitly indexed to short-term LIBOR rates and reset accordingly. It is expected that amounts due upon maturity of our reverse repos will be funded primarily through the roll/re-initiation of reverse repos and, if we are unable or unwilling to roll/re-initiate our reverse repos, through free cash and proceeds from the sale of securities.

Although we typically finance most of our holdings of Agency RMBS, as of March 31, 2013 and December 31, 2012, we held unencumbered Agency pools, on a settlement date basis, in the amount of $46.6 million and $28.4 million, respectively.

We held cash and cash equivalents of approximately $64.8 million and $59.1 million as of March 31, 2013 and December 31, 2012, respectively.

We may declare dividends based on, among other things, our earnings, our financial condition, our working capital needs, and new opportunities. Dividends are declared and paid on a quarterly basis in arrears. The declaration of dividends to our shareholders and the amount of such dividends are at the discretion of our Board of Directors. During the three month period ended March 31, 2013, we paid total dividends in the amount of $31.9 million related to net income attributable to the three month period and year ended December 31, 2012. In May 2013, our Board of Directors approved a dividend related to the first quarter of 2013 in the amount of $0.77 per share, or approximately $16.2 million, payable on June 17, 2013 to shareholders of record as of May 31, 2013. During the three month period ended March 31, 2012, we paid total dividends in the amount of $6.7 million related to net income attributable to the three month period ended December 31, 2011.

The following tables set forth the dividend distributions authorized by the Board of Directors payable to shareholders and LTIP holders for the periods indicated below:

Three Month Period Ended March 31, 2013

(In thousands except per share amounts)	Dividend Per Share	Dividend Amount		Record Date	Payment Date
First Quarter	$0.77	$16,186	*	May 31, 2013	June 17, 2013

* Estimated

Three Month Period Ended March 31, 2012

(In thousands except per share amounts)	Dividend Per Share	Dividend Amount	Record Date	Payment Date
First Quarter	$0.70	$11,787	June 1, 2012	June 15, 2012

Dividends are declared and paid on a quarterly basis in arrears.

For the three month period ended March 31, 2013, our operating activities used net cash in the amount of $26.5 million. Our reverse repo activity used to finance many of our investments (including repayments, in conjunction with the sales of investments, of amounts borrowed under our reverse repo agreements) provided net cash of $59.6 million. Our operating activities, when combined with our reverse repo financings, provided net cash of $33.0 million for the three month period ended March 31, 2013. In addition contributions from a non-controlling interest member provided cash of $4.7 million. We used $31.9 million to pay dividends and $0.1 million for other non-operating activity-related uses. As a result there was an increase in our cash holdings of $5.7 million from $59.1 million as of December 31, 2012 to $64.8 million as of March 31,

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2013.
For the three month period ended March 31, 2012, our operating activities used net cash of $31.1 million. Additionally our reverse repo activity used to finance many of our investments (including repayments, in conjunction with the sales of investments, of amounts borrowed under our reverse repo agreements) provided net cash of $25.2 million. Proceeds from the issuance of securitized debt provided net cash of $1.5 million. Thus our operating activities, when combined with our reverse repo financing and securitized debt financings, used net cash of $4.4 million for the three month period ended March 31, 2012. In addition to this $4.4 million, we used $6.7 million to pay dividends and $0.04 million for other non-operating activity-related uses, resulting in a decrease in our cash holdings of $11.2 million from $62.7 million as of December 31, 2011 to $51.5 million as of March 31, 2012.
Based on our current portfolio, amount of free cash on hand, debt-to-equity ratio and current and anticipated availability of credit, we believe that our capital resources will be sufficient to enable us to meet anticipated short-term and long-term liquidity requirements. However, the unexpected inability to finance our Agency RMBS portfolio would create a serious short-term strain on our liquidity and would require us to liquidate much of that portfolio, which in turn would require us to restructure our portfolio to maintain our exclusion from regulation as an investment company under the Investment Company Act. Steep declines in the values of our RMBS assets financed using reverse repos, or in the values of our derivative contracts, would result in margin calls that would significantly reduce our free cash position. Furthermore, a substantial increase in prepayment rates on our assets financed by reverse repos could cause a temporary liquidity shortfall, because we are generally required to post margin on such assets in proportion to the amount of the announced principal paydowns before the actual receipt of the cash from such principal paydowns. If our cash resources are at any time insufficient to satisfy our liquidity requirements, we may have to sell assets or issue debt or additional equity securities.
We are not required by our investment guidelines to maintain any specific debt-to-equity ratio, and we believe that the appropriate leverage for the particular assets we hold depends on the credit quality and risk of those assets, as well as the general availability and terms of stable and reliable financing for those assets.
Contractual Obligations and Commitments
We are a party to a management agreement with our Manager. Pursuant to that agreement, our Manager is entitled to receive a base management fee, an incentive fee, reimbursement of certain expenses and, in certain circumstances, a termination fee. Such fees and expenses do not have fixed and determinable payments. For a description of the management agreement provisions, see Note 5 of the notes to our consolidated financial statements.
We enter into reverse repos with third-party broker-dealers whereby we sell securities to such broker-dealers at agreed-upon purchase prices at the initiation of the reverse repos and agree to repurchase such securities at predetermined repurchase prices and termination dates, thus providing the broker-dealers with an implied interest rate on the funds initially transferred to us by the broker-dealers. When we enter into a reverse repo, the lender establishes and maintains an account containing cash and securities having a value not less than the repurchase price, including accrued interest, of the reverse repo. We enter into repos with third-party broker-dealers whereby we purchase securities under agreements to resell at an agreed-upon price and date. In general, we most often enter into repo transactions in order to effectively borrow securities that we can then deliver to counterparties to whom we have made short sales of the same securities. The implied interest rates on the repos and reverse repos we enter into are based upon market rates at the time of initiation. Repos and reverse repos that are conducted with the same counterparty may be reported on a net basis if they meet the requirements of ASC 210-20, Balance Sheet, Offsetting. See "Liquidity and Capital Resources" for a summary of our borrowings on reverse repos.
As of March 31, 2013, we had an aggregate amount at risk under our reverse repos with twelve counterparties of approximately $190.0 million and as of December 31, 2012, we had an aggregate amount at risk under our reverse repos with ten counterparties of approximately $159.9 million. Amounts at risk represent the aggregate excess, if any, for each counterparty of the fair value of collateral held by such counterparty over the amounts outstanding under reverse repos. If the amounts outstanding under repos and reverse repos with a particular counterparty are greater than the collateral held by the counterparty, there is no amount at risk for the particular counterparty. Amount at risk as of March 31, 2013 and December 31, 2012 does not include approximately $2.3 million and $2.5 million, respectively, of net accrued interest, defined as accrued interest on securities held as collateral less interest payable on cash

borrowed.

Our swap and futures contracts are governed by trading agreements, which are separately negotiated agreements with dealer counterparties. Changes in the relative value of the swap and futures transactions may require us or the counterparty to post or receive collateral. Typically, a collateral payment or receipt is triggered based on the net change in the value of all contracts governed by a particular trading agreement. Entering into swap and futures contracts involves market risk in excess of amounts recorded on our balance sheet.

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As of March 31, 2013, we had an aggregate amount at risk under our derivative contracts with seven counterparties of approximately $13.1 million. As of December 31, 2012, we had an aggregate amount at risk under our derivatives contracts with eight counterparties of approximately $13.0 million. Amounts at risk under our derivatives contracts represent the aggregate excess, if any, for each counterparty of the fair value of our derivative contracts plus our collateral held directly by the counterparty less the counterparty's collateral held by us. If a particular counterparty's collateral held by us is greater than the aggregate fair value of the financial derivatives plus our collateral held directly by the counterparty, there is no amount at risk for the particular counterparty.

We are party to a tri-party collateral arrangement under one of our ISDA trading agreements whereby a third party holds collateral posted by us. Pursuant to the terms of the arrangement, the third party must follow certain pre-defined actions prior to the release of the collateral to the counterparty or to us. Deposits with dealers held as collateral on the Consolidated Statement of Assets, Liabilities, and Equity includes, at March 31, 2013 and December 31, 2012 collateral posted by the Company and held by a third party custodian in the amount of approximately $5.0 million and $7.1 million, respectively.

We purchase and sell TBAs and Agency pass-through certificates on a when-issued or delayed delivery basis. The delayed delivery for these securities means that these transactions are more prone to market fluctuations between the trade date and the ultimate settlement date, and thereby are more vulnerable, especially in the absence of margining arrangements with respect to these transactions, to increasing amounts at risk with the applicable counterparties.

As of March 31, 2013, in connection with our forward settling TBA and Agency pass-through certificates, we had an aggregate amount at risk with five counterparties of approximately $1.3 million. As of December 31, 2012, in connection with our forward settling TBA and Agency pass-through certificates, we had an aggregate amount at risk with eight counterparties of approximately $1.4 million. Amounts at risk in connection with our forward settling TBA and Agency pass-through certificates represent the aggregate excess, if any, for each counterparty of the net fair value of the forward settling securities plus our collateral held directly by the counterparty less the counterparty's collateral held by us. If a particular counterparty's collateral held by us is greater than the aggregate fair value of the forward settling securities plus our collateral held directly by the counterparty, there is no amount at risk for the particular counterparty.

Off-Balance Sheet Arrangements

As of March 31, 2013 and December 31, 2012, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide funding to any such entities. As such, we are not materially exposed to any market, credit, liquidity or financing risk that could arise if we had engaged in such relationships.

Inflation

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our activities and balance sheet are measured with reference to historical cost and/or fair market value without considering inflation.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The primary components of our market risk at March 31, 2013 and December 31, 2012 are related to credit risk, prepayment risk and interest rate risk. We seek to actively manage these and other risks and to acquire and hold assets that we believe justify bearing those risks, and to maintain capital levels consistent with those risks.

Credit Risk

We are subject to credit risk in connection with many of our assets, especially non-Agency MBS. Credit losses on real estate loans can occur for many reasons, including, but not limited to, poor origination practices, fraud, faulty appraisals, documentation errors, poor underwriting, legal errors, poor servicing practices, weak economic conditions, decline in the value of homes, businesses or commercial properties, special hazards, earthquakes and other natural events, over-leveraging of the borrower on the property, reduction in market rents and occupancies and poor property management services, changes in legal protections for lenders, reduction in personal income, job loss, and personal

events such as divorce or health problems. Property values are subject to volatility and may be affected adversely by a number of factors, including, but not limited to, national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors), local real estate conditions (such as an oversupply of housing), changes or continued weakness in specific industry segments,

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construction quality, age and design, demographic factors and retroactive changes to building or similar codes. For mortgage-related instruments, the two primary components of credit risk are default risk and severity risk.

Default Risk

Default risk is the risk that borrowers will fail to make principal and interest payments on their mortgage loans. We may attempt to mitigate our default risk by, among other things, opportunistically entering into credit default swaps on individual RMBS or MBS indices, whereby we would receive payments upon the occurrence of a credit event on the underlying reference asset or assets. We also rely on third-party mortgage servicers to mitigate our default risk, but such third-party mortgage servicers may have little or no economic incentive to mitigate loan default rates.

Severity Risk

Severity risk is the risk of loss upon a borrower default on a mortgage loan underlying our RMBS. Severity risk includes the risk of loss of value of the property underlying the mortgage loan as well as the risk of loss associated with taking over the property, including foreclosure costs. We rely on third-party mortgage servicers to mitigate our severity risk, but such third-party mortgage servicers may have little or no economic incentive to mitigate loan loss severities. Such mitigation efforts may include loan modification programs and prompt foreclosure and property liquidation following a default.

Much of the uncertainty as to the timing and magnitude of loan loss severities can be attributed to the uncertainty in foreclosure timelines. Because of the magnitude of the housing crisis, and in response to the well-publicized failures of many servicers to follow proper foreclosure procedures (such as involving "robo-signing"), mortgage servicers are being held to much higher foreclosure-related documentation standards than they previously were. However, because many mortgages have been transferred and assigned multiple times (and by means of varying assignment procedures) throughout the origination, warehouse and securitization processes, mortgage servicers are generally having much more difficulty furnishing the requisite documentation to initiate or complete foreclosures. This leads to stalled or suspended foreclosure proceedings and ultimately additional foreclosure-related costs. Foreclosure-related delays also tend to increase ultimate loan loss severities as a result of property deterioration, amplified legal and other costs, and other factors. The risk of extended foreclosure timelines is very difficult to quantify, and uncertainty has often been magnified by court cases with conflicting outcomes.

Prepayment Risk

Prepayment risk is the risk of change, whether an increase or a decrease, in the rate at which principal is returned in respect of mortgage loans underlying RMBS, including both through voluntary prepayments and through liquidations due to defaults and foreclosures. This rate of prepayment is affected by a variety of factors, including the prevailing level of interest rates as well as economic, demographic, tax, social, legal, and other factors. Changes in prepayment rates will have varying effects on the different types of securities in our portfolio, and we attempt to take these effects into account in making asset management decisions. Additionally, increases in prepayment rates may cause us to experience losses on our interest only securities and inverse interest only securities, as those securities are extremely sensitive to prepayment rates. In the current record low interest rate environment, one might typically expect record high prepayment rates; however, as mortgage originators have tightened their lending standards and have also made the refinancing process far more cumbersome, the current level of prepayments is not nearly what would otherwise be expected. Prepayment rates, besides being subject to interest rates and borrower behavior, are also substantially affected by government policy and regulation. For example, prepayment risk has been heightened by the Federal Reserve’s stated commitment to keep interest rates low in order to spur increased growth in the U.S. economy. The government sponsored HARP program, designed to encourage mortgage refinancings, has also become a factor in prepayment risk. Mortgage rates are currently at historic lows and it appears likely that refinancings will increase over the near to medium term, especially in light of government activities.

Interest Rate Risk

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. We are subject to interest rate risk in connection with most of our assets and liabilities. For some securities in our portfolio, the coupon interest rates on, and therefore also the values of, such securities are highly sensitive to interest rate movements, such as inverse floating rate RMBS, which benefit from falling interest rates, or certain deep discount floating rate RMBS,

which benefit from rising interest rates. We selectively hedge our interest rate risk by entering into interest rate swaps, TBAs, U.S. Treasury securities, Eurodollar futures, and other instruments. In general, such hedging instruments are used to offset the large majority of the interest rate risk we estimate to arise from our Agency RMBS positions. Hedging instruments may also be used to offset a portion of the interest rate risk arising from certain non-Agency MBS positions.

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The following sensitivity analysis table shows the estimated impact on the value of our portfolio segregated by certain identified categories as of March 31, 2013, assuming a static portfolio and immediate and parallel shifts in interest rates from current levels as indicated below.

(In thousands)	Estimated Change in value for a Decrease in Interest Rates by		Estimated Change in value for a Increase in Interest Rates by	
Category of Instruments	50 Basis Points	100 Basis Points	50 Basis Points	100 Basis Points
Agency RMBS	$ 10,215	$ 20,762	$ (9,883)	$ (19,433)
Non-Agency RMBS, CMBS, Other ABS, and Commercial Mortgage Loans	8,370	16,877	(8,233)	(16,329)
U.S. Treasury Securities, Interest Rate Swaps, and Eurodollar Futures	(15,266)	(31,055)	14,744	28,967
Mortgage-Related Derivatives	(666)	(1,064)	933	2,132
Repurchase Agreements and Reverse Repurchase Agreements	(789)	(887)	881	1,761
Total	$ 1,864	$ 4,633	$ (1,558)	$ (2,902)

The preceding analysis does not show sensitivity to changes in interest rates for our derivatives on corporate securities (whether debt or equity-related), or other categories of instruments for which we believe that the effect of a change in interest rates is not material to the value of the overall portfolio and/or cannot be accurately estimated.

Our analysis of interest rate risk is derived from Ellington’s proprietary models as well as third party information and analytics. Many assumptions have been made in connection with the calculations set forth in the table above and, as such, there can be no assurance that assumed events will occur or that other events will not occur that would affect the outcomes. For example, for each hypothetical immediate shift in interest rates, assumptions have been made as to the response of mortgage prepayment rates, the shape of the yield curve, and market volatilities of interest rates; each of the foregoing factors can significantly and adversely affect the fair value of our interest rate-sensitive instruments.

The above analysis utilizes assumptions and estimates based on management’s judgment and experience, and relies on financial models, which are inherently imperfect; in fact, different models can produce different results for the same securities. While the table above reflects the estimated impacts of immediate parallel interest rate increases and decreases on specific categories of instruments in our portfolio, we actively trade many of the instruments in our portfolio, and therefore our current or future portfolios may have risks that differ significantly from those of our March 31, 2013 portfolio estimated above. Moreover, the impact of changing interest rates on fair value can change significantly when interest rates change by a greater amount than the hypothetical shifts assumed above. Furthermore, our portfolio is subject to many risks other than interest rate risks, and these additional risks may or may not be correlated with changes in interest rates. For all of the foregoing reasons and others, the table above is for illustrative purposes only and actual changes in interest rates would likely cause changes in the actual fair value of our portfolio that would differ from those presented above, and such differences might be significant and adverse. See "-Special Note Regarding Forward-Looking Statements."

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to our management as appropriate to allow timely decisions regarding required disclosures. An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of March 31, 2013. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of March 31, 2013.

Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Neither we nor our Manager is currently subject to any legal proceedings that we or our Manager considers material. Nevertheless, we, our Manager and Ellington operate in highly regulated markets that currently are under intense regulatory scrutiny, and Ellington and its affiliates have received, and we expect in the future that they may receive, inquiries and requests for documents and information from various federal, state and foreign regulators. See "Risk Factors -We or Ellington or its affiliates may be subject to regulatory inquiries or proceedings" included in Part 1A of our Annual Report on Form 10-K for the year ended December 31, 2012. Ellington has advised us that, at the present time, it is not aware that any material legal proceeding against Ellington and its affiliates is contemplated in connection with any such inquiries or requests. However, we believe that the continued scrutiny of CDO and mortgage market participants (including large CDO collateral managers such as Ellington) increases the risk of additional inquiries and requests from regulatory or enforcement agencies. Ellington and we cannot provide any assurance that these inquiries and requests will not result in further investigation of or the initiation of a proceeding against Ellington or its affiliates or that, if any such investigation or proceeding were to arise, it would not materially adversely affect our company.

Item 1A. Risk Factors

For information regarding factors that could affect our results of operations, financial condition, and liquidity, see the risk factors discussed under "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012. There have been no material changes from these previously disclosed risk factors. See also "Special Note Regarding Forward-Looking Statements," included in Part I, Item 2 of this Quarterly Report on Form 10-Q.

Item 2. Unregistered Sales of Equity Securities

In connection with the formation of our Operating Partnership 212,000 Partnership units were issued to EMG Holdings, L.P., an affiliate of our Manager, pursuant to an exemption from registration under Regulation D of the Securities Act. The Partnership units may be redeemed in exchange for cash or, at the Company’s option, the Company’s common shares on a one-for-one basis.

On February 12, 2013, we issued 33,254 common shares to our Manager as part of its incentive fee pursuant to our management agreement with our Manager. This issuance was exempt from the registration requirements of the Securities Act based on the exemption provided by Section 4(2) of the Securities Act.

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Item 2. Exhibits

Exhibit	Description
3.1	Second Amended and Restated Operating Agreement of Ellington Financial LLC (incorporated by reference to the registration statement on Form S-11 (No. 333-160562), filed on July 14, 2009, as amended).
3.2	First Amendment to Second Amended and Restated Operating Agreement of Ellington Financial LLC (incorporated by reference to the quarterly report on Form 10-Q for the quarterly period ended June 30, 2011).
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes – Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes – Oxley Act of 2002
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes – Oxley Act of 2002
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes – Oxley Act of 2002
101**	The following financial information from Ellington Financial LLC’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statement of Assets, Liabilities and Equity, (ii) Consolidated Statement of Operations, (iii) Consolidated Statements of Changes in Equity, (iv) Consolidated Statements of Cash Flows and (v) Notes to Consolidated Financial Statements.

* Furnished herewith. These certifications are not deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

** Users of this data are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	ELLINGTON FINANCIAL LLC.
Date: May 8, 2013	By: /s/ LAURENCE PENN
	Laurence Penn
	Chief Executive Officer
	(Principal Executive Officer)

	ELLINGTON FINANCIAL LLC.
Date: May 8, 2013	By: /s/ LISA MUMFORD
	Lisa Mumford
	Chief Financial Officer
	(Principal Financial and Accounting Officer)

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