

MFA MORTGAGE INVESTMENTS
Form 10-Q
November 03, 2008

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

FORM 10-Q

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

For the quarterly period ended September 30, 2008

OR

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

For the transition period from _____ to _____

Commission File Number: 1-13991

MFA MORTGAGE INVESTMENTS, INC.
(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

13-3974868
(I.R.S. Employer
Identification No.)

350 Park Avenue, 21st Floor, New York, New
York
(Address of principal executive offices)

10022
(Zip Code)

(212) 207-6400
(Registrant's telephone number, including area code)

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

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

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Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

206,720,374 shares of the registrant's common stock, \$0.01 par value, were outstanding as of October 29, 2008.

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MFA MORTGAGE INVESTMENTS, INC.
CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Per Share Amounts)	September 30, 2008 (Unaudited)	December 31, 2007
Assets:		
Investment securities at fair value (including pledged mortgage-backed securities ("MBS") of \$10,097,782 and \$8,046,947 at September 30, 2008 and December 31, 2007, respectively) (Notes 3, 7 and 9)	\$ 10,260,648	\$ 8,302,797
Cash and cash equivalents (Note 2(c))	438,530	234,410
Restricted cash (Note 2(d))	-	4,517
Interest receivable (Note 4)	51,318	43,610
Interest rate swap agreements ("Swaps"), at fair value (Notes 2(m), 5 and 9)	8,172	103
Real estate, net (Note 6)	11,410	11,611
Goodwill (Note 2(f))	7,189	7,189
Prepaid and other assets	1,787	1,622
Total Assets	\$ 10,779,054	\$ 8,605,859
Liabilities:		
Repurchase agreements (Note 7)	\$ 9,379,474	\$ 7,526,014
Accrued interest payable	20,464	20,212
Mortgage payable on real estate (Note 6)	9,347	9,462
Swaps, at fair value (Notes 2(m), 5 and 9)	58,612	99,836
Dividends and dividend equivalents payable (Note 10(b))	-	18,005
Accrued expenses and other liabilities	7,055	5,067
Total Liabilities	9,474,952	7,678,596
Commitments and contingencies (Note 8)		
Stockholders' Equity:		
Preferred stock, \$.01 par value; series A 8.50% cumulative redeemable; 5,000 shares authorized; 3,840 shares issued and outstanding at September 30, 2008 and December 31, 2007 (\$96,000 aggregate liquidation preference) (Note 10)	\$ 38	\$ 38
Common stock, \$.01 par value; 370,000 shares authorized; 206,556 and 122,887 issued and outstanding at September 30, 2008 and December 31, 2007, respectively (Note 10)	2,067	1,229
Additional paid-in capital, in excess of par	1,702,242	1,085,760
Accumulated deficit	(163,410)	(89,263)
Accumulated other comprehensive loss (Note 12)	(236,835)	(70,501)
Total Stockholders' Equity	1,304,102	927,263
Total Liabilities and Stockholders' Equity	\$ 10,779,054	\$ 8,605,859

The accompanying notes are an integral part of the consolidated financial statements.

MFA MORTGAGE INVESTMENTS, INC.
CONSOLIDATED STATEMENTS OF INCOME

(In Thousands, Except Per Share Amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(Unaudited)			
Interest Income:				
Investment securities (Note 3)	\$ 139,419	\$ 95,590	\$ 383,026	\$ 270,329
Cash and cash equivalent investments	1,529	1,126	6,711	2,208
Interest Income	140,948	96,716	389,737	272,537
Interest Expense (Note 7)				
Interest Expense (Note 7)	85,033	81,816	255,166	232,424
Net Interest Income	55,915	14,900	134,571	40,113
Other (Loss)/Income:				
Net loss on sales of MBS (Note 3)	-	(22,027)	(24,530)	(22,140)
Other-than-temporary impairment on investment securities (Note 3)	(183)	-	(5,051)	-
Revenue from operations of real estate (Note 6)	407	405	1,219	1,231
Loss on termination of Swaps, net (Note 5(a))	(986)	(560)	(92,467)	(384)
Miscellaneous other income, net	68	103	247	327
Other Losses	(694)	(22,079)	(120,582)	(20,966)
Operating and Other Expense:				
Compensation and benefits (Note 13)	3,264	1,819	8,595	4,840
Real estate operating expense and mortgage interest (Note 6)	439	451	1,312	1,300
New business initiative (Note 14)	-	-	998	-
Other general and administrative expense	1,465	1,241	3,936	3,669
Operating and Other Expense	5,168	3,511	14,841	9,809
Income/(Loss) from Continuing Operations	50,053	(10,690)	(852)	9,338
Discontinued Operations: (Note 6)				
Gains-tax refunds	-	257	-	257
Income from Discontinued Operations	-	257	-	257
Net Income/(Loss) Before Preferred Stock Dividends	50,053	(10,433)	(852)	9,595
Less: Preferred Stock Dividends	2,040	2,040	6,120	6,120
Net Income/(Loss) to Common Stockholders	\$ 48,013	\$ (12,473)	\$ (6,972)	\$ 3,475
Income/(Loss) Per Share of Common Stock: (Note 11)				
Income/(loss) per share from continuing operations – basic and diluted	\$ 0.24	\$ (0.15)	\$ (0.04)	\$ 0.04
Income from discontinued operations – basic and diluted	-	-	-	-
Income/(Loss) Per Share of Common Stock – Basic and Diluted	\$ 0.24	\$ (0.15)	\$ (0.04)	\$ 0.04

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Dividends Declared Per Share of Common Stock (Note 10(b))	\$	0.20	\$	0.09	\$	0.38	\$	0.17
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Weighted average shares outstanding:								
Basic		199,406		85,986		170,111		82,893
Diluted		199,849		85,986		170,111		82,927

The accompanying notes are an integral part of the consolidated financial statements.

MFA MORTGAGE INVESTMENTS, INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(In Thousands, Except Per Share Amounts)	Nine Months Ended September 30, 2008 (Unaudited)
Preferred Stock, Series A 8.50% Cumulative Redeemable – Liquidation Preference \$25.00 per share:	
Balance at September 30, 2008 and December 31, 2007 (3,840 shares)	\$ 38
Common Stock, Par Value \$0.01:	
Balance at December 31, 2007 (122,887 shares)	1,229
Issuance of common stock (83,669 shares)	838
Balance at September 30, 2008 (206,556 shares)	2,067
Additional Paid-in Capital, in Excess of Par:	
Balance at December 31, 2007	1,085,760
Issuance of common stock, net of expenses	615,584
Share-based compensation expense	944
Shares withheld upon exercise of common stock options (22 shares)	(46)
Balance at September 30, 2008	1,702,242
Accumulated Deficit:	
Balance at December 31, 2007	(89,263)
Net loss	(852)
Dividends declared on common stock	(66,858)
Dividends declared on preferred stock	(6,120)
Dividends declared on dividend equivalent rights (“DERs”)	(317)
Balance at September 30, 2008	(163,410)
Accumulated Other Comprehensive Loss:	
Balance at December 31, 2007	(70,501)
Unrealized losses on investment securities, net	(215,627)
Unrealized gains on Swaps	49,293
Balance at September 30, 2008	(236,835)
Total Stockholders' Equity at September 30, 2008	\$ 1,304,102

The accompanying notes are an integral part of the consolidated financial statements.

MFA MORTGAGE INVESTMENTS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)	Nine Months Ended September 30,	
	2008	2007
	(Unaudited)	
Cash Flows From Operating Activities:		
Net (loss)/income	\$ (852)	\$ 9,595
Adjustments to reconcile net (loss)/income to net cash provided by operating activities:		
Losses on sales of MBS	25,101	22,143
Gains on sales of MBS	(571)	(3)
Losses on termination of Swaps	92,467	627
Gain on termination of Swaps	-	(243)
Amortization of purchase premiums on MBS, net of accretion of discounts	15,335	22,780
Amortization of premium cost for interest rate cap agreements ("Caps")	-	278
Increase in interest receivable	(7,708)	(2,830)
Depreciation and amortization on real estate, including discontinued operations	355	315
Increase in other assets and other	(319)	(610)
Increase in accrued expenses and other liabilities	1,988	1,188
Increase/(decrease) in accrued interest payable	252	(4,417)
Other-than-temporary impairment charges	5,051	-
Tax refunds-discontinued operations	-	(257)
Equity-based compensation expense	944	240
Negative amortization and principal accretion on investment securities	(493)	(266)
Net cash provided by operating activities	131,550	48,540
Cash Flows From Investing Activities:		
Principal payments on MBS and other investment securities	1,119,414	1,384,417
Proceeds from sales of MBS	1,851,019	705,723
Purchases of MBS and other investment securities	(5,188,932)	(2,655,870)
Net cash used by investing activities	(2,218,499)	(565,730)
Cash Flows From Financing Activities:		
Decrease in restricted cash	4,517	-
Principal payments on repurchase agreements	(44,159,270)	(30,175,629)
Proceeds from borrowings under repurchase agreements	46,012,730	30,766,867
Payments on termination of Swaps	(91,868)	(384)
Proceeds from issuances of common stock	616,376	110,769
Dividends paid on preferred stock	(6,120)	(6,120)
Dividends paid on common stock and DERs	(85,181)	(19,009)
Principal payments on mortgage	(115)	(109)
Net cash provided by financing activities	2,291,069	676,385
Net increase in cash and cash equivalents	204,120	159,195
Cash and cash equivalents at beginning of period	234,410	47,200
Cash and cash equivalents at end of period	\$ 438,530	\$ 206,395

The accompanying notes are an integral part of the consolidated financial statements.

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MFA MORTGAGE INVESTMENTS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007 (Unaudited)	2008	2007
Net income/(loss) before preferred stock dividends	\$ 50,053	\$ (10,433)	\$ (852)	\$ 9,595
Other Comprehensive Income/(Loss):				
Unrealized (loss)/gain on investment securities, net	(152,191)	17,841	(208,886)	4,071
Reclassification adjustment for MBS sales	-	11,757	(8,241)	10,875
Reclassification adjustment for net losses included in net income/(loss) for other-than-temporary impairments	96	-	1,500	-
Unrealized loss on Caps arising during period, net	-	-	-	(83)
Unrealized(loss)/gain on Swaps arising during period, net	(10,448)	(42,461)	321	(27,956)
Reclassification adjustment for net losses included in net income/(loss) from Swaps	773	-	48,972	-
Comprehensive loss before preferred stock dividends	\$ (111,717)	\$ (23,296)	\$ (167,186)	\$ (3,498)
Dividends on preferred stock	(2,040)	(2,040)	(6,120)	(6,120)
Comprehensive Loss to Common Stockholders	\$ (113,757)	\$ (25,336)	\$ (173,306)	\$ (9,618)

The accompanying notes are an integral part of the consolidated financial statements.

MFA MORTGAGE INVESTMENTS, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Organization

MFA Mortgage Investments, Inc. (the “Company”) was incorporated in Maryland on July 24, 1997 and began operations on April 10, 1998. The Company has elected to be treated as a real estate investment trust (“REIT”) for U.S. federal income tax purposes. In order to maintain its qualification as a REIT, the Company must comply with a number of requirements under federal tax law, including that it must distribute at least 90% of its annual net taxable ordinary net income to its stockholders, subject to certain adjustments. (See Note 10(b).)

2. Summary of Significant Accounting Policies

(a) Basis of Presentation and Consolidation

The accompanying interim unaudited financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted according to such SEC rules and regulations. Management believes, however, that these disclosures are adequate to make the information presented therein not misleading. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007. In the opinion of management, all normal and recurring adjustments necessary to present fairly the financial condition of the Company at September 30, 2008 and results of operations for all periods presented have been made. The results of operations for the nine-month period ended September 30, 2008 should not be construed as indicative of the results to be expected for the full year.

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

(b) MBS/Investment Securities

The Company's investment securities are comprised primarily of hybrid and adjustable-rate MBS (collectively, “ARM-MBS”) that are issued or guaranteed as to principal and/or interest by a federally chartered corporation, such as Fannie Mae or Freddie Mac, or an agency of the U.S. government, such as Ginnie Mae (collectively, “Agency MBS”), or are rated AAA by a nationally recognized rating agency, such as Moody's Investors Services, Inc., Standard & Poor's Corporation (“S&P”) or Fitch, Inc. (“Rating Agencies”). Hybrid MBS have interest rates that are fixed for a specified period and, thereafter, generally reset annually. To a lesser extent, the Company also holds investments in non-Agency MBS, mortgage-related securities and other investments that are rated below AAA. At September 30, 2008, the Company held securities with a carrying value of \$26.0 million rated below AAA. (See Note 3.)

The Company accounts for its investment securities in accordance with Statement of Financial Accounting Standards (“FAS”) No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” which requires that investments in securities be designated as either “held-to-maturity,” “available-for-sale” or “trading” at the time of acquisition. All of the Company's investment securities are designated as available-for-sale and are carried at their fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income/(loss), a component of Stockholders' Equity. (See Notes 2(k) and 9.) The Company determines the fair value of its investment securities based upon prices obtained from a third-party pricing service and broker quotes. The Company applies the guidance prescribed in Financial Accounting Standards Board (“FASB”) Staff Position FAS 115-1 and FAS 124-1, “The Meaning

of Other-Than-Temporary Impairment and its Application to Certain Investments” (the “FASB Impairment Position”). (See Note 2(e).)

Although the Company generally intends to hold its investment securities until maturity, it may, from time to time, sell any of its securities as part of the overall management of its business. The available-for-sale designation provides the Company with the flexibility to sell its investment securities. Upon the sale of an investment security, any unrealized gain or loss is reclassified out of accumulated other comprehensive income/(loss) to earnings as a realized gain or loss using the specific identification method.

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Interest income is accrued based on the outstanding principal balance of the investment securities and their contractual terms. Premiums and discounts associated with the Agency MBS and MBS rated AA and higher are amortized into interest income over the life of such securities using the effective yield method, adjusted for actual prepayment activity in accordance with FAS No. 91, "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases." Certain of the Agency MBS owned by the Company contractually provide for negative amortization, which occurs when the full amount of the stated coupon interest due on the distribution date for an MBS is not received from the underlying mortgages. The Company recognizes such interest shortfall on its Agency MBS as interest income with a corresponding increase in the related Agency MBS principal value (i.e., par) as the interest shortfall is guaranteed by the issuing agency.

Interest income on the Company's securities rated A or lower, is recognized in accordance with Emerging Issues Task Force ("EITF") of the FASB Consensus No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets" ("EITF 99-20"). Pursuant to EITF 99-20, 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 initial investment is recognized as interest income under the effective yield method. The Company reviews and, if appropriate, makes adjustments to its cash flow projections at least quarterly and monitors these projections based on input and analysis received from external sources, internal models, and its judgment about interest rates, prepayment rates, the timing and amount of credit losses 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 each security, the Company assesses the applicability of EITF 99-20 at the date of acquisition and on a subsequent basis for securities that have experienced both an other-than-temporary impairment and a downgrade in rating to single A or lower by a Rating Agency. (See Note 3.)

The Company's MBS pledged as collateral against repurchase agreements and Swaps are included in investment securities on the Consolidated Balance Sheets and the value of the MBS pledged are disclosed parenthetically. (See Notes 3 and 7.)

(c) Cash and Cash Equivalents

Cash and cash equivalents include cash on deposit with financial institutions and investments in high quality overnight money market funds, all of which have original maturities of three months or less. At September 30, 2008 all of the Company's cash investments were in high quality overnight money market funds. The carrying amount of cash equivalents is deemed to be their fair value.

On September 29, 2008, the U.S. Treasury Department announced that it had opened its Temporary Guarantee Program for Money Market Funds, under which it guarantees the share price of eligible money market funds that apply and pay for inclusion in the program. The program covers shareholders of participating funds as of the close of business on September 19, 2008. Each of the money market funds in which the Company is invested has elected to participate in the program. As a result, up to \$421.7 million of the Company's money market investments was insured as of September 30, 2008. The program will be in effect for an initial three-month period, after which the Secretary of the U.S. Treasury Department will have the option to renew the program up to the close of business on September 18, 2009.

(d) Restricted Cash

Restricted cash represents cash held in interest-bearing accounts by counterparties as collateral against the Company's Swaps and/or repurchase agreements. Restricted cash is not available to the Company for general corporate purposes,

but may be applied against payments due to Swap or repurchase agreement counterparties or returned to the Company when the collateral requirements are exceeded or, at the maturity of the Swap or repurchase agreement. The Company did not have restricted cash at September 30, 2008 and had restricted cash of \$4.5 million pledged against its Swaps at December 31, 2007. (See Notes 5 and 7.)

(e) Credit Risk/Other-Than-Temporary Impairment

The Company limits its exposure to credit losses on its investment portfolio by requiring that at least 50% of its investment portfolio consist of hybrid and adjustable-rate MBS that are either (i) Agency MBS or (ii) rated in one of the two highest rating categories by at least one Rating Agency. The remainder of the Company's investment portfolio may consist of direct or indirect investments in: (i) other types of MBS and residential mortgage loans; (ii) other mortgage and real estate-related debt and equity; (iii) other yield instruments (corporate or government); and (iv) other types of assets approved by the Company's Board of Directors (the "Board") or a committee thereof. At

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September 30, 2008, all of the Company's MBS were secured by first lien mortgages on one-to-four family properties. At September 30, 2008, 93.4% of the Company's assets consisted of Agency MBS and related receivables, 2.0% were MBS rated AAA by a Rating Agency and related receivables and 4.1% were cash and cash equivalents combined these assets comprised 99.5% of the Company's total assets. The Company's remaining assets consisted of Swaps, an investment in real estate, securities rated below AAA, goodwill, prepaid, and other assets. (See Note 3.)

The Company recognizes impairments on its investment securities in accordance with the FASB Impairment Position, which, among other things, specifically addresses: the determination as to when an investment is considered impaired; whether that impairment is other-than-temporary; the measurement of an impairment loss; accounting considerations subsequent to the recognition of an other-than-temporary impairment; and certain required disclosures about unrealized losses that have not been recognized as other-than-temporary impairments.

The Company assesses its investment securities for other-than-temporary impairment on at least a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either "temporary" or "other-than-temporary." If it is determined that impairment is other-than-temporary, then an impairment loss is recognized in earnings reflecting the entire difference between the investment's cost basis and its fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment is not permitted to include partial recoveries subsequent to the balance sheet date. Following the recognition of an other-than-temporary impairment, the fair value of the investment becomes the new cost basis of the investment and is not adjusted for subsequent recoveries in fair value through earnings. Because management's assessments are based on factual information as well as subjective information available at the time of assessment, the determination as to whether an other-than-temporary impairment exists and, if so, the amount considered other-than-temporarily impaired, or not impaired, is subjective and, therefore, the timing and amount of other-than-temporary impairments constitute material estimates that are susceptible to significant change.

Upon a decision to sell an impaired available-for-sale investment security on which the Company does not expect the fair value of the investment to fully recover prior to the expected time of sale, the investment shall be deemed other-than-temporarily impaired in the period in which the decision to sell is made. The Company recognizes an impairment loss when the impairment is deemed other-than-temporary even if a decision to sell has not been made. Even if the inability to collect is not probable, the Company may recognize an other-than-temporary loss if, for example, the Company does not have the intent and ability to hold a security until its fair value has recovered. The Company did not recognize any other-than-temporary impairment on any of its Agency MBS during the three or nine months ended September 30, 2008 and September 30, 2007.

Certain of the Company's non-Agency investment securities were purchased at a discount to par value, with a portion of such discount considered credit protection against future credit losses. The initial credit protection (i.e., discount) on these MBS may be adjusted over time, based on review of the investment or, if applicable, its underlying collateral, actual and projected cash flow from such collateral, economic conditions and other factors. If the performance of these securities is more favorable than forecasted, a portion of the amount designated as credit discount may be accreted into interest income over time. Conversely, if the performance of these securities is less favorable than forecasted, impairment charges and write-downs of such securities to a new cost basis could result. During the nine months ended September 30, 2008, the Company recognized impairment charges of \$5.1 million against its non-Agency investment securities, of which \$183,000 was recognized during the three months ended September 30, 2008 in accordance with EITF 99-20. The Company did not have any impairment charges against any of its investment securities during the three and nine months ended September 30, 2007. At September 30, 2008, the

Company had \$26.0 million, or 0.2% of its assets, invested in investment securities rated below AAA, which had an amortized cost of \$43.7 million. (See Note 3.)

(f) Goodwill

The Company accounts for its goodwill in accordance with FAS No. 142, "Goodwill and Other Intangible Assets" ("FAS 142") which provides, among other things, how entities are to account for goodwill and other intangible assets that arise from business combinations or are otherwise acquired. FAS 142 requires that goodwill be tested for impairment annually or more frequently under certain circumstances. At September 30, 2008 and December 31, 2007, the Company had goodwill of \$7.2 million, which represents the unamortized portion of the excess of the fair value of its common stock issued over the fair value of net assets acquired in connection with its

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formation in 1998. Goodwill is tested for impairment at least annually at the entity level. Through September 30, 2008, the Company had not recognized any impairment against its goodwill.

(g) Real Estate

At September 30, 2008, the Company indirectly held 100% of the ownership interest in Lealand Place, a 191-unit apartment property located in Lawrenceville, Georgia (“Lealand”), which is consolidated with the Company. This property was acquired through a tax-deferred exchange under Section 1031 of the Internal Revenue Code of 1986, as amended (the “Code”). (See Note 6.)

The property, capital improvements and other assets held in connection with this investment are carried at cost, net of accumulated depreciation and amortization. Maintenance, repairs and minor improvements are expensed in the period incurred, while real estate assets, except land, and capital improvements are depreciated over their useful life using the straight-line method.

(h) Repurchase Agreements

The Company finances the acquisition of its MBS through the use of repurchase agreements. Under these repurchase agreements, the Company sells securities to a lender and agrees to repurchase the same securities in the future for a price that is higher than the original sale price. The difference between the sale price that the Company receives and the repurchase price that the Company pays represents interest paid to the lender. Although structured as a sale and repurchase, under repurchase agreements, the Company pledges its securities as collateral to secure a loan which is equal in value to a specified percentage of the fair value of the pledged collateral, while the Company retains beneficial ownership of the pledged collateral. At the maturity of a repurchase agreement, the Company is required to repay the loan and concurrently receives back its pledged collateral from the lender. With the consent of the lender, the Company may renew a repurchase agreement at the then prevailing financing terms. Margin calls, whereby a lender requires that the Company pledge additional securities or cash as collateral to secure borrowings under its repurchase agreements with such lender, are routinely experienced by the Company as the value of the MBS pledged as collateral declines due to scheduled monthly amortization and prepayments of principal on such MBS. In addition, margin calls may also occur when the fair value of the MBS pledged as collateral declines due to changes in market interest rates, spreads or other market conditions. Through September 30, 2008, the Company had satisfied all of its margin calls and had not sold assets in response to any margin call. (See Note 7.)

Original terms to maturity of the Company’s repurchase agreements generally range from one month to 60 months. Should a counterparty decide not to renew a repurchase agreement at maturity, the Company must either refinance elsewhere or be in a position to satisfy the obligation. If, during the term of a repurchase agreement, a lender should file for bankruptcy, the Company might experience difficulty recovering its pledged assets and may have an unsecured claim against the lender’s assets for the difference between the amount loaned to the Company plus interest due to the counterparty and the fair value of the collateral pledged to such lender. The Company had no outstanding borrowings at September 30, 2008 with Lehman Brothers Holdings Inc. (“Lehman”), who filed for bankruptcy in September 2008, or any of its subsidiaries, nor was Lehman significant to the Company’s borrowing capacity. The Company generally seeks to diversify its exposure by entering into repurchase agreements with at least four separate lenders with a maximum loan from any lender of no more than three times the Company’s stockholders’ equity. At September 30, 2008, the Company had outstanding balances under repurchase agreements with 16 separate lenders with a maximum net exposure (the difference between the amount loaned to the Company, including interest payable, and the fair value of the securities pledged by the Company as collateral, including accrued interest on such securities) to any single lender of \$95.5 million related to repurchase agreements, or 7.3% of stockholders’ equity. (See Note 7.)

(i) Equity Based Compensation

The Company accounts for its stock-based compensation in accordance with FAS No. 123R, "Share-Based Payment," ("FAS 123R"). The Company uses the Black-Scholes-Merton option model to value its stock options. There are limitations inherent in this model, as with all other models currently used in the market place to value stock options. For example, the Black-Scholes-Merton option model has not been designed to value stock options which contain significant restrictions and forfeiture risks, such as those contained in the stock options that are issued to certain employees. Significant assumptions are made in order to determine the Company's option value, all of which are subjective. The fair value of the Company's stock options are expensed using the straight-line method.

Pursuant to FAS 123R, compensation expense for restricted stock awards, restricted stock units ("RSUs") and stock options is recognized over the vesting period of such awards, based upon the fair value of such awards at the

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grant date. DERs attached to such awards are charged to stockholders' equity when declared. Equity based awards for which there is no risk of forfeiture are expensed upon grant, or at such time that there is no longer a risk of forfeiture. A zero forfeiture rate is applied to the Company's equity based awards, given that such awards have been granted to a limited number of employees, (primarily long-term executives that have employment agreements with the Company) and that historical forfeitures have been minimal. Should information arise indicating that forfeitures may occur, the forfeiture rate would be revised and accounted for as a change in estimate. To the extent that dividends or DERs are paid pursuant to the terms of any unvested equity based awards, the grantees of such awards are not required to return such payments to the Company. Accordingly, payments made on any such awards that ultimately do not vest are recognized as additional compensation expense at the time an award is forfeited. With respect to certain restricted stock grants, however, dividends accrue to the benefit of the grantee but are only paid to the extent that these restricted shares vest. To the extent that these restricted stock grants are forfeited by the grantee prior to vesting, all accrued but unpaid dividends will be retained by the Company. There were no forfeitures of any equity based compensation awards during the three and nine month periods ended September 30, 2008 and September 30, 2007. (See Note 13.)

(j) Earnings per Common Share ("EPS")

Basic EPS is computed by dividing net income/(loss) allocable to holders of common stock by the weighted average number of shares of common stock outstanding during the period. Diluted EPS is computed by dividing net income/(loss) available to holders of common stock by the weighted average shares of common stock and common equivalent shares outstanding during the period. For the diluted EPS calculation, common equivalent shares outstanding includes the weighted average number of shares of common stock outstanding adjusted for the effect of dilutive unexercised stock options, non-vested restricted shares and non-vested RSUs outstanding using the treasury stock method. Under the treasury stock method, common equivalent shares are calculated assuming that all dilutive common stock equivalents are exercised and the proceeds, along with future compensation expenses for unvested stock options and RSUs, are used to repurchase shares of the Company's outstanding common stock at the average market price during the reporting period. No dilutive common share equivalents are included in the computation of any diluted per share amount for a period in which a net operating loss is reported. (See Note 11.)

(k) Comprehensive Income/(Loss)

Comprehensive income/(loss) for the Company includes net income/(loss), the change in net unrealized gains/(losses) on investment securities and derivative hedging instruments, adjusted by realized net gains/(losses) included in net income/(loss) for the period and reduced by dividends on the Company's preferred stock.

(l) U.S. Federal Income Taxes

The Company has elected to be taxed as a REIT under the provisions of the Code and the corresponding provisions of state law. The Company expects to operate in a manner that will enable it to continue to be taxed as a REIT. A REIT is not subject to tax on its earnings to the extent that it distributes its taxable ordinary net income to its stockholders. As such, no provision for current or deferred income taxes has been made in the accompanying consolidated financial statements.

(m) Derivative Financial Instruments/Hedging Activity

The Company hedges a portion of its interest rate risk through the use of derivative financial instruments, which, to date, have been comprised of Swaps and Caps (collectively, "Hedging Instruments"). The Company accounts for Hedging Instruments in accordance with FAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133") as amended by FAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and FAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." The

Company's Hedging Instruments are carried on the balance sheet at their fair value, as assets, if their fair value is positive, or as liabilities, if their fair value is negative. Since the Company's Hedging Instruments are designated as "cash flow hedges," the change in the fair value of any such instrument is recorded in other comprehensive income/(loss) provided that the hedge is effective. The change in fair value of any ineffective amount of a Hedging Instrument is recognized in earnings. To date, the Company has recognized gains and losses realized on Swaps that have been terminated early and deemed ineffective. The Company has not recognized any change in the value of its Hedging Instruments in earnings as a result of any Hedging Instrument or a portion thereof being ineffective.

Upon entering into hedging transactions, the Company documents the relationship between the Hedging Instruments and the hedged liability. The Company also documents its risk-management policies, including

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objectives and strategies, as they relate to its hedging activities. The Company assesses, both at inception of a hedge and on an on-going basis, whether or not the hedge is “highly effective,” as defined by FAS 133. The Company discontinues hedge accounting on a prospective basis and recognizes changes in fair value reflected in earnings when: (i) it is determined that the derivative is no longer effective in offsetting cash flows of a hedged item (including forecasted transactions); (ii) it is no longer probable that the forecasted transaction will occur; or (iii) it is determined that designating the derivative as a Hedging Instrument is no longer appropriate.

The Company utilizes Hedging Instruments to manage a portion of its interest rate risk and does not enter into derivative transactions for speculative or trading purposes. (See Notes 2(n) and 5.)

Interest Rate Swaps

No cost is incurred by the Company at the inception of a Swap. Based upon the contractual terms of a Swap Agreement, which vary by counterparty, the Company is required to pledge cash or securities equal to a specified percentage of the notional amount of the Swap to the counterparty as collateral, or may be entitled to receive collateral from a Swap counterparty. The Company does not offset cash collateral receivables or payables against its net derivative positions. The Company did not have restricted cash at September 30, 2008 and had restricted cash of \$4.5 million pledged against its Swaps at December 31, 2007. If, during the term of the Swap, a Counterparty should file for bankruptcy, the Company might experience difficulty recovering its pledged assets and may have an unsecured claim against the counterparty’s assets for the difference between the fair value of the Swap and the fair value of the collateral pledged to such counterparty. When the Company enters into a Swap, it agrees to pay a fixed rate of interest and to receive a variable interest rate, based on the London Interbank Offered Rate (“Libor”). The Company’s Swaps are designated as cash flow hedges against certain of its current and forecasted borrowings under repurchase agreements.

While the fair value of the Company’s Swaps are reflected in the consolidated balance sheets, the notional amounts are not. All changes in the value of Swaps are recorded in accumulated other comprehensive income/(loss), provided that the hedge remains effective. The Company’s Swaps are valued by a third party pricing service, which prices are independently reviewed by the Company for reasonableness. If it becomes probable that the forecasted transaction (which in this case refers to interest payments to be made under the Company’s short-term borrowing agreements) will not occur by the end of the originally specified time period, as documented at the inception and throughout the term of the hedging relationship, then the related gain or loss in accumulated other comprehensive income/(loss) is recognized through earnings.

The gain or loss from a terminated Swap remains in accumulated other comprehensive income/(loss) until the forecasted interest payments affect earnings. However, if it is probable that the forecasted interest payments will not occur, then the entire gain or loss is recognized through earnings.

(n) Adoption of New Accounting Standards and Interpretations

Fair Value Measurements

On January 1, 2008, the Company adopted FAS No. 157, “Fair Value Measurements” (“FAS 157”), which defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements.

The changes to previous practice resulting from the application of FAS 157 relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. The definition of fair value retains the exchange price notion used in earlier definitions of fair value. FAS 157 clarifies that the exchange price is the price in an orderly transaction, that is not a forced liquidation or distressed sale, between market

participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. FAS 157 provides a consistent definition of fair value which focuses on exit price and prioritizes, within a measurement of fair value, the use of market-based inputs over entity-specific inputs in active markets. In addition, FAS 157 provides a framework for measuring fair value, and establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. (See Notes 2(o) and 9.)

FAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (“FAS 159”) permits entities to elect to measure many financial instruments and certain other items at fair value. Unrealized gains and

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losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. A decision to elect the fair value option for an eligible financial instrument, which can be made on an instrument by instrument basis, is irrevocable. The Company's adoption of FAS 159 on January 1, 2008 did not have a material impact on its consolidated financial statements, as the Company did not elect the fair value option.

FASB Interpretation No. 39-1, "Amendment of FASB Interpretation ("FIN") No. 39." ("FIN 39-1"), defines "right of setoff" and specifies what conditions must be met for a derivative contract to qualify for this right of setoff. FIN 39-1 also addresses the applicability of a right of setoff to derivative instruments and clarifies the circumstances in which it is appropriate to offset amounts recognized for those instruments in the balance sheet. In addition, FIN 39-1 permits offsetting of fair value amounts recognized for multiple derivative instruments executed with the same counterparty under a master netting arrangement and fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from the same master netting arrangement as the derivative instruments. The Company does not offset cash collateral receivables or payables against its net derivative positions. The Company's adoption of FIN 39-1 on January 1, 2008 did not have any impact on its consolidated financial statements. The Company did not have restricted cash at September 30, 2008 and had restricted cash of \$4.5 million pledged against its Swaps at December 31, 2007.

On March 20, 2008, the FASB issued FAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" ("FAS 161"). FAS 161 provides for enhanced disclosures about how and why an entity uses derivatives and how and where those derivatives and related hedged items are reported in the entity's financial statements. FAS 161 also requires certain tabular formats for disclosing such information. FAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008 (i.e., calendar year 2009 for the Company) with early application encouraged. FAS 161 applies to all entities and all derivative instruments and related hedged items accounted for under FAS 133. Among other things, FAS 161 requires disclosures of an entity's objectives and strategies for using derivatives by primary underlying risk and certain disclosures about the potential future collateral or cash requirements (that is, the effect on the entity's liquidity) as a result of contingent credit-related features. The Company's adoption of FAS 161 on June 30, 2008, resulted in additional disclosures about the Company's Hedging Instruments which did not have any impact on the Company's results of operations or financial condition.

(o) Recently Issued Accounting Standards

In February 2008, the FASB issued FASB Staff Position ("FSP") 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions," ("FSP 140-3"), which provides guidance on accounting for transfers of financial assets and repurchase financings. FSP 140-3 presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (i.e., a linked transaction) under FAS No. 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("FAS 140"). However, if certain criteria, as described in FSP 140-3, are met, the initial transfer and repurchase financing shall not be evaluated as a linked transaction and shall be evaluated separately under FAS 140. If the linked transaction does not meet the requirements for sale accounting, the linked transaction shall generally be accounted for as a forward contract, as opposed to the current presentation, where the purchased asset and the repurchase liability are reflected separately on the balance sheet.

FSP 140-3 is effective on a prospective basis for fiscal years beginning after November 15, 2008, with earlier application not permitted. The Company does not expect that the adoption of FSP 140-3, will have a material impact on the Company's financial statements.

In June 2007, the American Institute of Certified Public Accountants (“AICPA”) issued Statement of Position (“SOP”) 07-01 “Clarification of the Scope of the Audit and Accounting Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies” (“SOP 07-1”) which provides guidance for determining whether an entity is within the scope of the guidance in the AICPA Audit and Accounting Guide for Investment Companies. On February 6, 2008, the FASB indefinitely deferred the effective date of SOP 07-1.

On October 10, 2008, the FASB issued FSP No. 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active” (“FSP 157-3”). FSP 157-3 clarifies the application of FAS 157 in a market that is not active and provides an example to illustrate key consideration in determining the fair value of a financial asset when the market for that financial asset is not active. The issuance of FSP 157-3 did not have any impact on the Company’s determination of fair value for its financial assets. (See notes 2(n) and 9.)

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(p) Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation.

3. Investment Securities

At September 30, 2008 and December 31, 2007, the Company's investment securities portfolio consisted primarily of pools of ARM-MBS. The Company's non-Agency MBS are categorized based on the lowest rating issued by a Rating Agency at balance sheet date. The following tables present certain information about the Company's investment securities at September 30, 2008 and December 31, 2007.

(In Thousands)	September 30, 2008							
	Principal/ Current Face	Purchase Premiums	Purchase Discounts	Amortized Cost (1)	Carrying Value/ Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Net Unrealized Gain/(Loss)
Agency MBS:								
Fannie Mae	\$ 9,195,875	\$ 118,028	\$ (1,424)	\$ 9,312,479	\$ 9,226,429	\$ 21,917	\$ (107,967)	\$ (86,050)
Ginnie Mae	32,047	570	-	32,617	32,290	27	(354)	(327)
Freddie Mac	747,660	11,260	-	771,692	765,110	635	(7,217)	(6,582)
Non-Agency MBS:								
Rated AAA (2)	284,709	2,036	(214)	286,531	210,853	-	(75,678)	(75,678)
Rated AA+	790	-	(3)	787	474	-	(313)	(313)
Rated A+	553	-	(2)	551	255	-	(296)	(296)
Rated BBB+	316	-	(4)	312	89	-	(223)	(223)
Rated BB (3)	42,652	-	(479)	41,990	25,120	-	(16,870)	(16,870)
Rated below BB	238	-	(154)	84	28	5	(61)	(56)
Total	\$ 10,304,840	\$ 131,894	\$ (2,280)	\$ 10,447,043	\$ 10,260,648	\$ 22,584	\$ (208,979)	\$ (186,395)

(In Thousands)	December 31, 2007							
	Principal/ Current Face	Purchase Premiums	Purchase Discounts	Amortized Cost (1)	Carrying Value/ Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Net Unrealized Gain/(Loss)
Agency MBS:								
Fannie Mae	\$ 7,157,079	\$ 91,610	\$ (706)	\$ 7,247,983	\$ 7,287,111	\$ 47,486	\$ (8,358)	\$ 39,128
Ginnie Mae	172,340	3,173	-	175,513	174,089	78	(1,502)	(1,424)
Freddie Mac	393,441	6,221	-	409,337	408,792	781	(1,326)	(545)
Non-Agency MBS:								
Rated AAA	430,025	2,341	(987)	431,379	424,954	97	(6,522)	(6,425)
Rated AA+	1,413	-	-	1,413	1,392	-	(21)	(21)
Rated A+	989	-	(3)	986	967	-	(19)	(19)
Rated BBB+	565	-	(6)	559	543	-	(16)	(16)
Rated BB and below	1,648	-	(136)	1,512	1,646	134	-	134
Unrated	3,095	-	(127)	2,968	1,689	35	(1,314)	(1,279)
Total MBS	\$ 8,160,595	\$ 103,345	\$ (1,965)	\$ 8,271,650	\$ 8,301,183	\$ 48,611	\$ (19,078)	\$ 29,533
Income notes (4)				1,915	1,614	-	(301)	(301)
Total	\$ 8,160,595	\$ 103,345	\$ (1,965)	\$ 8,273,565	\$ 8,302,797	\$ 48,611	\$ (19,379)	\$ 29,232

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- (1) Includes principal payments receivable, which are not included in the Principal/Current Face. Amortized cost is reduced by other-than-temporary impairments recognized.
- (2) On October 28, 2008, S&P downgraded one MBS to BBB. This MBS, which remained rated AAA by Fitch, Inc, had an amortized cost of \$39.1 million and a fair value of \$25.0 million.
- (3) Includes one MBS with an amortized cost of \$41.9 million and a fair value of \$25.1 million that was rated BB by S&P and rated AAA by Fitch, Inc.
- (4) Other investments are comprised of income notes, which are unrated securities collateralized by capital securities of a diversified pool of issuers, consisting primarily of depository institutions and insurance companies. In June 2008, the Company wrote-off its remaining investment in income notes, taking a \$1.0 million impairment charge against such investment.

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Agency MBS: Agency MBS are guaranteed as to principal and/or interest by a federally chartered corporation, such as Fannie Mae or Freddie Mac, or an agency of the U.S. government, such as Ginnie Mae, and, as such, carry an implied AAA rating. The payment of principal and/or interest on Ginnie Mae MBS is backed by the full faith and credit of the U.S. government. During the third quarter of 2008, Fannie Mae and Freddie Mac were placed in conservatorship under the newly-created Federal Housing Finance Agency (“FHFA”). By placing Fannie Mae and Freddie Mac under conservatorship, it is believed that there is now significantly stronger backing for these guarantors.

Non-Agency MBS: The Company’s non-Agency MBS are certificates that are backed by pools of single-family mortgage loans, which are not guaranteed by the U.S. government, any federal agency or any federally chartered corporation. Non-Agency MBS may be rated from AAA to B by one or more of the Rating Agencies or may be unrated (i.e., not assigned a rating by any of the Rating Agencies). The rating indicates the credit worthiness of the investment, indicating the obligor’s ability to meet its financial commitment on the obligation.

The following table presents information about the Company’s investment securities that were in an unrealized loss position at September 30, 2008.

(In Thousands)	Unrealized Loss Position For:							
	Less than 12 Months			12 Months or more			Total	
	Fair Value	Unrealized losses	Number of Securities	Fair Value	Unrealized losses	Number of Securities	Fair Value	Unrealized losses
Agency MBS:								
Fannie Mae	\$ 5,616,014	\$ 97,611	295	\$ 560,813	\$ 10,356	111	\$ 6,176,827	\$ 107,967
Ginnie Mae	14,749	116	8	9,426	238	6	24,175	354
Freddie Mac	594,056	6,248	44	40,948	969	28	635,004	7,217
Non-Agency MBS:								
Rated AAA (1)	104,332	46,866	2	106,521	28,812	13	210,853	75,678
Rated AA+	-	-	-	474	313	1	474	313
Rated A+	-	-	-	255	296	1	255	296
Rated BBB+	-	-	-	88	223	1	88	223
Rated BB (2)	25,061	16,870	1	-	-	-	25,061	16,870
Rated below BB	22	61	1	-	-	-	22	61
Total temporarily impaired securities	\$ 6,354,234	\$ 167,772	351	\$ 718,525	\$ 41,207	161	\$ 7,072,759	\$ 208,979

(1) On October 28, 2008, S&P downgraded one AAA rated MBS, which had an amortized cost of \$39.1 million and a fair value of \$25.0 million at September 30, 2008, to BBB. This MBS remained rated AAA by Fitch, Inc.

(2) Is comprised of one non-Agency MBS, with an amortized cost of \$41.9 million, that was rated BB by S&P and rated AAA by Fitch, Inc.

The Company monitors the performance and market value of its investment securities portfolio on an ongoing basis. During the nine months ended September 30, 2008, the Company recognized aggregate other-than-temporary impairment charges of \$5.1 million against BB rated non-Agency MBS and unrated investment securities, of which \$183,000 was recognized during the three months ended September 30, 2008.

At September 30, 2008, the Company determined that it had the intent and ability to hold its securities in an unrealized loss position until market recovery or maturity. As such, the Company considers the impairment of its securities to be temporary. The receipt of principal, at par, and interest on Agency MBS is guaranteed by the respective Agency guarantor and the decline in the value of the non-Agency MBS was not related to the performance of these securities but rather an overall widening of spreads for many types of fixed income products, due to reduced liquidity in the market. The Company's assessment of its ability and intent to continue to hold its securities may change over time, given, among other things, the dynamic nature of markets and other variables. Future sales or changes in the Company's assessment of its ability and/or intent to hold impaired investment securities could result in the Company recognizing other-than-temporary impairment charges or realizing losses on sales in the future.

In March 2008, in response to tightening of credit conditions, the Company adjusted its balance sheet strategy decreasing its target debt-to-equity multiple range to 7x to 9x from its historical range of 8x to 9x. In order to

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reduce its borrowings, the Company sold MBS with an amortized cost of \$1.876 billion and realized aggregate net losses of \$24.5 million, comprised of gross losses of \$25.1 million and gross gains of \$571,000. During the quarter ended September 30, 2008, the Company continued to target a relatively low, on an historical basis, leverage multiple. As of September 30, 2008, the Company's debt-to-equity multiple was 7.2x. The Company has not sold any investment securities since it modified its leverage strategy in March 2008.

The following table presents the impact of the Company's investment securities on its other comprehensive income/(loss) for the three and nine months ended September 30, 2008 and 2007.

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Accumulated other comprehensive income/(loss) from investment securities:				
Unrealized (loss)/gain on investment securities at beginning of period	\$ (34,300)	\$ (45,647)	\$ 29,232	\$ (30,995)
Unrealized (loss)/gain on investment securities, net	(152,191)	17,841	(208,886)	4,071
Reclassification adjustment for MBS sales included in net income/(loss)	-	11,757	(8,241)	10,875
Reclassification adjustment for other-than-temporary impairment included in net income/(loss)	96	-	1,500	-
Balance at the end of period	\$ (186,395)	\$ (16,049)	\$ (186,395)	\$ (16,049)

The following table presents components of interest income on the Company's investment securities portfolio for the three and nine months ended September 30, 2008 and 2007.

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Coupon interest on MBS	\$ 143,844	\$ 101,817	\$ 398,311	\$ 293,002
Interest on income notes	-	50	50	107
Premium amortization	(4,486)	(6,377)	(15,549)	(22,936)
Discount accretion	61	100	214	156
Interest income on investment securities, net	\$ 139,419	\$ 95,590	\$ 383,026	\$ 270,329

The following table presents certain information about the Company's MBS that will reprice or amortize based on contractual terms, which do not consider prepayments assumptions, at September 30, 2008.

Months to Coupon Reset or Contractual Payment (Dollars in Thousands)	September 30, 2008		
	Fair Value	% of Total	WAC (1)
Within one month	\$ 469,996	4.6%	5.13%

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One to three months	56,592	.6	5.79
Three to 12 Months	435,987	4.2	5.23
One to two years	581,016	5.7	5.08
Two to three years	2,131,780	20.7	5.95
Three to five years	1,734,167	16.9	5.50
Five to 10 years	4,851,110	47.3	5.58
Total	\$ 10,260,648	100.0%	5.58%

(1) "WAC" is the weighted average coupon rate on the Company's MBS, which is higher than the net yield that will be earned on such MBS. The net yield is primarily reduced by net premium amortization and the contractual delay in receiving payments, which delay varies by issuer.

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The following table presents information about the Company's MBS pledged as collateral under repurchase agreements and in connection with Swaps at September 30, 2008.

(In Thousands)	MBS Pledged Under Repurchase Agreements			MBS Pledged Against Swaps			Total Fair Value of MBS Pledged and Accrued Interest
	Fair Value/ Carrying Value	Amortized Cost	Accrued Interest on Pledged MBS	Fair Value/ Carrying Value	Amortized Cost	Accrued Interest on Pledged MBS	
MBS Pledged:							
Fannie Mae	\$ 9,069,987	\$ 9,152,944	\$ 41,910	\$ 44,480	\$ 44,829	\$ 198	\$ 9,156,575
Freddie Mac	700,672	706,283	6,487	25,488	25,823	235	732,882
Ginnie Mae	22,709	22,956	104	3,892	3,912	19	26,724
Rated AAA	205,493	278,663	1,286	-	-	-	206,779
Rated BB	25,061	41,931	209	-	-	-	25,270
	\$ 10,023,922	\$ 10,202,777	\$ 49,996	\$ 73,860	\$ 74,564	\$ 452	\$ 10,148,230

4. Interest Receivable

The following table presents the Company's interest receivable by investment category at September 30, 2008 and December 31, 2007.

(In Thousands)	September 30, 2008	December 31, 2007
MBS interest receivable:		
Fannie Mae	\$ 42,635	\$ 36,376
Freddie Mac	6,958	4,177
Ginnie Mae	151	870
Rated AAA	1,320	2,070
Rated AA	4	7
Rated A & A-	3	5
Rated BBB and BBB-	1	3
Rated BB	210	2
Rated below BB	1	5
Total MBS interest receivable	\$ 51,283	\$ 43,515
Income notes	-	3
Money market investments	35	92
Total interest receivable	\$ 51,318	\$ 43,610

5. Hedging Instruments

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As part of the Company's interest rate risk management process, it periodically hedges a portion of its interest rate risk by entering into derivative financial instrument contracts. For the nine months ended September 30, 2008, the Company's derivatives were entirely comprised of Swaps, which have the effect of modifying the repricing characteristics of the Company's repurchase agreements and cash flows on such liabilities.

The following table presents the fair value of derivative instruments and their location in the Company's Consolidated Balance Sheets at September 30, 2008 and December 31, 2007.

Derivates Designated as Hedging Instruments Under Statement 133	Balance Sheet Location	September 30, 2008	December 31, 2007
(In Thousands)			
Swap assets	Assets-Swaps, at fair value	\$ 8,172	\$ 103
Swap liabilities	Liabilities-Swaps, at fair value	(58,612)	(99,836)
		\$ (50,440)	\$ (99,733)

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The following table presents the impact of the Company's Hedging Instruments, on the Company's accumulated other comprehensive income/(loss) for the three and nine months ended September 30, 2008 and 2007.

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Accumulated other comprehensive (loss)/income from Hedging Instruments:				
Balance at beginning of period	\$ (40,765)	\$ 15,024	\$ (99,733)	\$ 602
Unrealized (losses)/gains on Hedging Instruments	(10,448)	(42,461)	321	(28,039)
Reclassification adjustment for net losses included in net income/(loss) from Hedging Instruments	773	-	48,972	-
Balance at the end of period	\$ (50,440)	\$ (27,437)	\$ (50,440)	\$ (27,437)

(a) Swaps

The Company is required to pledge assets as collateral for certain of its Swaps, which collateral requirements vary by counterparty and change over time based on the market value, notional amount, and remaining term of the Swap. Certain of the Company's Swap agreements include financial covenants, which, if breached, could cause an event of default or early termination event to occur under such agreements. If the Company were to cause an event of default or trigger an early termination event under one of its Swap agreements, the counterparty to such agreement may have the option to terminate all of its outstanding Swap transactions with the Company and, if applicable, any close-out amount due to the counterparty upon termination of such transactions would be immediately payable by the Company pursuant to such agreement. The Company remained in compliance with all of such financial covenants as of September 30, 2008.

The Company had MBS with a fair value of \$73.9 million and \$79.9 million pledged as collateral against its Swaps at September 30, 2008 and December 31, 2007, respectively. The Company had no cash pledged against its Swaps at September 30, 2008 and \$4.5 million of restricted cash pledged against Swaps at December 31, 2007.

The use of Hedging Instruments exposes the Company to counterparty credit risks. In the event of a default by a Swap counterparty, the Company may not receive payments to which it is entitled under the terms of its Swap agreements, and may have difficulty receiving back its assets pledged as collateral against such Swaps. On September 15, 2008, Lehman filed a petition for bankruptcy. At that time, the Company had two Swaps outstanding with Lehman Brothers Special Financing Inc. ("LBSF"), a subsidiary guaranteed by Lehman, with an aggregate notional amount of \$27.5 million. The bankruptcy filing of Lehman, which was LBSF's credit support provider, triggered an event of default under the master swap agreement between the Company and LBSF. As a result, the Company exercised its early termination rights with respect to these Swaps, which were in a liability position to the Company at the time. In accordance with the terms of the master swap agreement, the Company calculated the aggregate amount payable to the Company by LBSF in respect of the early termination of the Swaps to be \$145,000, which represented the set off amount by which the value of the collateral pledged by the Company to LBSF pursuant to the terms of the Swaps exceeded the contractual settlement amount of the Company's net liability upon termination of the Swaps. As a result, the Company forfeited its collateral, comprised of restricted cash and one MBS, held by LBSF and recognized an aggregate loss of \$986,000 upon early termination of the Swaps. This loss was comprised of the contractual settlement amount of \$841,000 owed by the Company to LBSF upon early termination of the Swaps and a \$145,000

write-off against an unsecured receivable from LBSF. At September 30, 2008, the Company was an unsecured creditor to LBSF with respect to the \$145,000 and anticipates filing a proof of claim with respect to such amount in connection with Lehman and LBSF's bankruptcy. At September 30, 2008, the Company had no outstanding contracts with Lehman and all of the Company's remaining Swap counterparties were rated "A" or better by a Rating Agency.

Certain of the Company's Swap agreements include financial covenants, which, if breached, could cause an event of default or early termination event to occur under such agreements. If the Company were to trigger an event of default or early termination event under one of its Swap agreements, the counterparty to such agreement may have the option to terminate all of its outstanding Swap transactions with the Company and, if applicable, any close-out amount due to the counterparty upon termination of such transactions would be immediately payable by the Company pursuant to such agreement, resulting in an adverse change in the Company's liquidity position. The

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Company was in compliance with all of its financial covenants as of September 30, 2008.

The following table presents the weighted average rate paid and received for the Company's Swaps and the net impact of Swaps on the Company's interest expense for the three and nine months ended September 30, 2008 and 2007.

(Dollars In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Weighted average Swap rate paid	4.18%	5.04%	4.33%	5.00%
Weighted average Swap rate received	2.64%	5.37%	3.15%	5.35%
Net addition to (reduction of) interest expense from Swaps	\$ 15,879	\$ (2,525)	\$ 39,774	\$ (6,346)

In March 2008, the Company terminated 48 Swaps with an aggregate notional amount of \$1.637 billion, resulting in net realized losses of \$91.5 million. In connection with the termination of these Swaps, the Company repaid the repurchase agreements that such Swaps hedged. To date, except for gains and losses realized on Swaps terminated early and deemed ineffective, the Company has not recognized any change in the value of its Hedging Instruments in earnings as a result of the hedge or a portion thereof being ineffective.

At September 30, 2008, the Company had Swaps with an aggregate notional balance of \$4.206 billion, (which included \$300.0 million of forward-starting swaps) which had gross unrealized losses of \$58.6 million and gross unrealized gains of \$8.2 million and extended 31 months on average with a maximum term of approximately seven years. At December 31, 2007, the Company had Swaps with an aggregate notional balance of \$4.628 billion, which had gross unrealized losses of \$99.8 million and gross unrealized gains of \$103,000.

The following table presents information about the Company's Swaps at September 30, 2008 and December 31, 2007.

Maturity (1) (Dollars In Thousands)	September 30, 2008		December 31, 2007	
	Notional Amount	Weighted Average Fixed Pay Interest Rate	Notional Amount	Weighted Average Fixed Pay Interest Rate
Within 30 days	\$ 80,941	3.94%	\$ 69,561	4.95%
Over 30 days to 3 months	155,499	4.13	179,207	4.79
Over 3 months to 6 months	230,044	4.05	233,753	4.83
Over 6 months to 12 months	426,309	4.05		