CAPSTEAD MORTGAGE CORP
Form 10-Q
November 05, 2014

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

FORM 10-Q

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

For the quarterly period ended: September 30, 2014

OR

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

For the transition period from ____________ to ______________

Commission File Number: 001-08896

CAPSTEAD MORTGAGE CORPORATION
(Exact name of Registrant as specified in its Charter)

Maryland	75-2027937
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

8401 North Central Expressway, Suite 800, Dallas, TX	75225-4404
(Address of principal executive offices)	(Zip Code)

(214) 874-2323
(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 þ NO o

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

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Common Stock ($0.01 par value) 95,810,735 as of November 5, 2014

CAPSTEAD MORTGAGE CORPORATION
FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2014
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PART I. ¾ FINANCIAL INFORMATION

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ITEM 1. FINANCIAL STATEMENTS

PART I. ¾ FINANCIAL INFORMATION

CAPSTEAD MORTGAGE CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share amounts)

	September 30, 2014 (unaudited)	December 31, 2013
Assets		
Residential mortgage investments ($13.40 and $13.12 billion pledged under repurchase arrangements at September 30, 2014 and December 31, 2013, respectively)	$13,722,281	$13,475,874
Cash collateral receivable from interest rate swap counterparties	42,716	25,502
Interest rate swap agreements at fair value	2,397	5,005
Cash and cash equivalents	438,622	413,356
Receivables and other assets	117,436	96,231
	$14,323,452	$14,015,968
Liabilities		
Repurchase arrangements and similar borrowings	$12,749,762	$12,482,900
Interest rate swap agreements at fair value	18,276	11,304
Unsecured borrowings	100,000	100,000
Common stock dividend payable	34,040	30,872
Accounts payable and accrued expenses	25,621	25,109
	12,927,699	12,650,185
Stockholders' equity		
Preferred stock - $0.10 par value; 100,000 shares authorized: 7.50% Cumulative Redeemable Preferred Stock, Series E, 7,544 and 6,861 shares issued and outstanding ($188,593 and $171,521 aggregate liquidation preference) at September 30, 2014 and December 31, 2013, respectively	182,102	165,756
Common stock - $0.01 par value; 250,000 shares authorized: 95,811 and 95,807 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively	958	958
Paid-in capital	1,327,595	1,329,792
Accumulated deficit	(346,885)	(349,866)
Accumulated other comprehensive income	231,983	219,143
	1,395,753	1,365,783
	$14,323,452	$14,015,968

See accompanying notes to consolidated financial statements.

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CAPSTEAD MORTGAGE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share amounts)
(unaudited)

	Quarter Ended September 30		Nine Months Ended September 30	
	2014	2013	2014	2013
Interest income:				
Residential mortgage investments	$53,862	$46,643	$170,399	$156,683
Other	78	48	216	267
	53,940	46,691	170,615	156,950
Interest expense:				
Repurchase arrangements and similar borrowings	(16,099)	(15,759)	(47,048)	(50,976)
Unsecured borrowings	(2,122)	(2,186)	(6,366)	(6,560)
	(18,221)	(17,945)	(53,414)	(57,536)
	35,719	28,746	117,201	99,414
Other revenue (expense):				
Salaries and benefits	(999)	(1,017)	(3,116)	(2,904)
Short-term incentive compensation	(613)	(1,333)	(1,550)	(2,213)
Long-term incentive compensation	(624)	(469)	(1,874)	(1,344)
Other general and administrative expense	(1,058)	(1,203)	(3,228)	(3,382)
Miscellaneous other revenue (expense)	(34)	(86)	(87)	(251)
	(3,328)	(4,108)	(9,855)	(10,094)
Income before equity in earnings of unconsolidated affiliates	32,391	24,638	107,346	89,320
Equity in earnings of unconsolidated affiliates	–	64	–	194
Net income	$32,391	$24,702	$107,346	$89,514
Net income available to common stockholders:				
Net income	$32,391	$24,702	$107,346	$89,514
Less dividends on preferred shares	(3,529)	(3,188)	(10,216)	(14,325)
Less redemption preference premiums paid	–	–	–	(19,924)
	$28,862	$21,514	$97,130	$55,265
Net income per common share:				
Basic	$0.30	$0.23	$1.02	$0.58
Diluted	0.30	0.23	1.02	0.58
Weighted average common shares outstanding:				
Basic	95,405	95,268	95,384	95,139
Diluted	95,677	95,416	95,614	95,373
Cash dividends declared per share:				
Common	$0.34	$0.31	$1.02	$0.93
Series A Preferred	–	–	–	0.72
Series B Preferred	–	–	–	0.57
Series E Preferred	0.47	0.47	1.41	0.79

See accompanying notes to consolidated financial statements.

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CAPSTEAD MORTGAGE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands, unaudited)

	Quarter Ended September 30		Nine Months Ended September 30	
	2014	2013	2014	2013
Net income	$32,391	$24,702	$107,346	$89,514
Other comprehensive income (loss)				
Amounts related to available-for-sale securities:				
Change in net unrealized gains	(10,720)	(27,539)	22,465	(104,037)
Amounts related to cash flow hedges:				
Change in net unrealized losses	97	(10,867)	(25,557)	9,136
Reclassification adjustment for amounts included in net income	5,826	3,698	15,932	13,548
	(4,797)	(34,708)	12,840	(81,353)
Comprehensive income (loss)	$27,594	$(10,006)	$120,186	$8,161

See accompanying notes to consolidated financial statements.

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CAPSTEAD MORTGAGE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands, unaudited)

	Nine Months Ended September 30	
	2014	2013
Operating activities:		
Net income	$107,346	$89,514
Noncash items:		
Amortization of investment premiums	75,713	101,072
Amortization of equity-based awards	2,074	1,640
Other depreciation and amortization	104	124
Change in measureable hedge ineffectiveness related to interest rate swap agreements designated as cash flow hedges	(44)	(148)
Net change in receivables, other assets, accounts payable and accrued expenses	(2,453)	1,924
Net cash provided by operating activities	182,740	194,126
Investing activities:		
Purchases of residential mortgage investments	(2,379,111)	(2,876,277)
Interest receivable acquired with the purchase of residential mortgage investments	(3,776)	(4,824)
Principal collections on residential mortgage investments, including changes in mortgage securities principal remittance receivable	2,064,608	2,790,124
Net cash used in investing activities	(318,279)	(90,977)
Financing activities:		
Proceeds from repurchase arrangements and similar borrowings	101,952,385	107,161,141
Principal payments on repurchase arrangements and similar borrowings	(101,685,521)	(107,326,800)
(Increase) decrease in cash collateral receivable from interest rate swap counterparties	(17,214)	22,143
Cash paid to redeem Series A & B preferred shares	–	(207,033)
Common share repurchases	–	(7,292)
Proceeds from issuance of preferred shares	16,346	164,310
Other capital stock transactions	(468)	(522)
Dividends paid	(104,723)	(99,439)
Net cash provided by (used in) financing activities	160,805	(293,492)
Net change in cash and cash equivalents	25,266	(190,343)
Cash and cash equivalents at beginning of period	413,356	425,445
Cash and cash equivalents at end of period	$438,622	$235,102

See accompanying notes to consolidated financial statements.

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CAPSTEAD MORTGAGE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2014
(unaudited)

NOTE 1 ¾ BUSINESS

Capstead Mortgage Corporation operates as a self-managed real estate investment trust for federal income tax purposes (a “REIT”) and is based in Dallas, Texas. Unless the context otherwise indicates, Capstead Mortgage Corporation, together with its subsidiaries, is referred to as “Capstead” or the “Company.” Capstead earns income from investing in a leveraged portfolio of residential mortgage pass-through securities consisting almost exclusively of adjustable-rate mortgage (“ARM”) securities issued and guaranteed by government-sponsored enterprises, either Fannie Mae or Freddie Mac (together, the “GSEs”), or by an agency of the federal government, Ginnie Mae. Residential mortgage pass-through securities guaranteed by the GSEs or Ginnie Mae are referred to as “Agency Securities” and are considered to have limited, if any, credit risk.

NOTE 2 ¾ BASIS OF PRESENTATION

Interim Financial Reporting and Reclassifications

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter and nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for the calendar year ending December 31, 2014. For further information refer to the audited consolidated financial statements and footnotes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2013. Certain prior period short- and long-term incentive compensation amounts have been reclassified from Salaries and benefits to separate line items in the Statements of Income to conform to the current year presentation.

Recent Accounting Pronouncements

In June 2014 the Financial Accounting Standards Board issued ASU 2014-11, Transfers and Servicing: Repurchase-to-Maturity Transactions, Repurchase Financings and Disclosures (the “ASU”). The ASU requires repurchase-to-maturity transactions to be accounted for as financings and eliminates existing guidance regarding so-called “linked transactions” between a buyer of securities and a seller that also provides related repurchase financings. The ASU also introduces new disclosure requirements and is effective for periods beginning after December 15, 2014. Adoption of the ASU is not expected to have any effect on Capstead’s financial statements.

NOTE 3 ¾ NET INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income, after deducting preferred share dividends and adjusting for the impact of unvested stock awards deemed to be participating securities, by the weighted average number of common shares outstanding, calculated excluding unvested stock awards.

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Diluted net income per common share is computed by dividing net income available to common stockholders, after adding dividends on the Company’s Series A and B convertible preferred shares (prior to their redemption in June 2013 and when such shares were dilutive), by the basic weighted average number of common shares and common share equivalents outstanding, giving effect to equity awards and convertible preferred shares when such awards and shares were dilutive. The Series A and B preferred shares were considered dilutive whenever basic net income per common share exceeded each Series’ dividend divided by the applicable conversion rates. Shares of the Company’s 7.50% Series E Cumulative Redeemable Preferred Stock first issued in May 2013 are contingently convertible into common shares only upon the occurrence of a change in control and are therefore not considered dilutive securities absent such an occurrence. Unvested stock awards that are deemed participating securities are included in the calculation of diluted net income per common share, if dilutive, under either the two-class method or the treasury stock method, depending upon which method produces the more dilutive result. Components of the computation of basic and diluted net income per common share for the indicated periods were as follows (dollars in thousands, except per share amounts):

	Quarter Ended September 30		Nine Months Ended September 30	
	2014	2013	2014	2013
Basic net income per common share				
Numerator for basic net income per common share:				
Net income	$32,391	$24,702	$107,346	$89,514
Redemption premiums paid on Series A and Series B preferred shares*	–	–	–	(19,924)
Preferred share dividends	(3,529)	(3,188)	(10,216)	(14,325)
Earnings participation of unvested stock awards	(24)	(32)	(58)	(96)
	$28,838	$21,482	$97,072	$55,169
Denominator for basic net income per common share:				
Weighted average common shares outstanding	95,793	95,761	95,779	95,647
Average unvested stock awards outstanding	(388)	(493)	(395)	(508)
	95,405	95,268	95,384	95,139
	$0.30	$0.23	$1.02	$0.58
Diluted net income per common share				
Numerator for diluted net income per common share:				
Net income available to common stockholders	$28,838	$21,482	$97,072	$55,169
Dividends on dilutive convertible preferred shares	–	–	–	44
	$28,838	$21,482	$97,072	$55,213
Denominator for diluted net income per common share:				
Basic weighted average common shares outstanding	95,405	95,268	95,384	95,139
Net effect of dilutive equity awards	272	148	230	133
Net effect of dilutive convertible preferred shares	–	–	–	101
	95,677	95,416	95,614	95,373
	$0.30	$0.23	$1.02	$0.58

Potentially dilutive securities excluded from the computation of net income per share because the effect of inclusion was antidilutive were as follows (in thousands):

	Quarter Ended September 30		Nine Months Ended September 30	
	2014	2013	2014	2013

Antidilutive convertible preferred shares*	–	–	–	16,539
Antidilutive equity awards excludable under the treasury stock method	–	35	–	35

* The Series A and Series B preferred shares were redeemed in June 2013 (See NOTE 9).

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NOTE 4 ¾ RESIDENTIAL MORTGAGE INVESTMENTS

Residential mortgage investments classified by collateral type and interest rate characteristics as of the indicated dates were as follows (dollars in thousands):

	Unpaid Principal Balance	Investment Premiums	Amortized Cost Basis	Carrying Amount (a)	Net WAC (b)	Average Yield (b)
September 30, 2014						
Agency Securities:						
Fannie Mae/Freddie Mac:						
Fixed-rate	$ 1,717	$ 5	$ 1,722	$ 1,724	6.64 %	6.17 %
ARMs	10,377,592	334,371	10,711,963	10,948,745	2.53	1.62
Ginnie Mae ARMs	2,660,875	92,454	2,753,329	2,764,458	2.65	1.50
	13,040,184	426,830	13,467,014	13,714,927	2.56	1.60
Residential mortgage loans:						
Fixed-rate	1,896	2	1,898	1,898	6.97	5.76
ARMs	3,373	14	3,387	3,387	3.86	2.89
	5,269	16	5,285	5,285	4.97	3.84
Collateral for structured financings	2,035	34	2,069	2,069	8.10	7.64
	$ 13,047,488	$ 426,880	$ 13,474,368	$ 13,722,281	2.56	1.60
December 31, 2013						
Agency Securities:						
Fannie Mae/Freddie Mac:						
Fixed-rate	$ 2,158	$ 6	$ 2,164	$ 2,167	6.67 %	6.47 %
ARMs	10,675,620	343,452	11,019,072	11,231,057	2.58	1.76
Ginnie Mae ARMs	2,145,639	74,396	2,220,035	2,233,495	2.64	1.64
	12,823,417	417,854	13,241,271	13,466,719	2.59	1.74
Residential mortgage loans:						
Fixed-rate	2,633	3	2,636	2,636	6.99	5.63
ARMs	4,244	18	4,262	4,262	3.81	3.35
	6,877	21	6,898	6,898	5.03	4.20
Collateral for structured financings	2,220	37	2,257	2,257	8.09	7.68
	$ 12,832,514	$ 417,912	$ 13,250,426	$ 13,475,874	2.59	1.74

(a) Includes unrealized gains and losses for residential mortgage investments classified as available-for-sale (see NOTE 10).

(b) Net WAC, or weighted average coupon, is the weighted average interest rate of the mortgage loans underlying the indicated investments net of servicing and other fees as of the indicated balance sheet date. Net WAC is expressed as a percentage calculated on an annualized basis on the unpaid principal balances of the mortgage loans underlying these investments. Average yield is presented for the quarter then ended, and is based on the cash component of interest income expressed as a percentage calculated on an annualized basis on average amortized cost basis (the “cash yield”) less the effects of amortizing investment premiums. Investment premium amortization is determined using the interest method and incorporates actual and anticipated future mortgage prepayments.

Because of federal government support for the GSEs, Agency Securities are considered to have limited, if any, credit risk. Residential mortgage loans held by Capstead were originated prior to 1995 when the Company operated a mortgage conduit and the related credit risk is borne by the Company. Collateral for structured financings consists of private residential mortgage securities that are backed by loans obtained through this mortgage conduit and are pledged to secure repayment of related structured financings. Credit risk for these securities is borne by the related bondholders. The maturity of Residential mortgage investments is directly affected by prepayments of principal on the underlying mortgage loans. Consequently, actual maturities will be significantly shorter than the portfolio's weighted average contractual maturity of 289 months.

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Fixed-rate investments consist of residential mortgage loans and Agency Securities backed by residential mortgage loans with fixed rates of interest. Adjustable-rate investments generally are ARM Agency Securities backed by residential mortgage loans that have coupon interest rates that adjust at least annually to more current interest rates or begin doing so after an initial fixed-rate period. After the initial fixed-rate period, if applicable, mortgage loans underlying ARM securities typically either (i) adjust annually based on specified margins over the one-year Constant Maturity U.S. Treasury Note Rate ("CMT") or the one-year London interbank offered rate ("LIBOR"), (ii) adjust semiannually based on specified margins over six-month LIBOR, or (iii) adjust monthly based on specified margins over indices such as one-month LIBOR, the Eleventh District Federal Reserve Bank Cost of Funds Index, or over a rolling twelve month average of the one-year CMT index, usually subject to periodic and lifetime limits, or caps, on the amount of such adjustments during any single interest rate adjustment period and over the contractual term of the underlying loans.

Capstead classifies its ARM securities based on each security's average number of months until coupon reset ("months to roll"). Months to roll is an indicator of asset duration which is a measure of market price sensitivity to interest rate movements. A shorter duration generally indicates less interest rate risk. Current-reset ARM securities have months to roll of less than 18 months while longer-to-reset ARM securities have months to roll of 18 months or greater. As of September 30, 2014, the average months to roll for the Company's $7.61 billion (amortized cost basis) in current-reset ARM securities was 6.2 months while the average months-to-roll for the Company's $5.86 billion (amortized cost basis) in longer-to-reset ARM securities was 39.8 months.

NOTE 5 ¾ INVESTMENTS IN UNCONSOLIDATED AFFILIATES

To facilitate the issuance of Unsecured borrowings, in 2006 and 2005 Capstead formed and capitalized three Delaware statutory trusts through the issuance to the Company of the trusts' common securities totaling $3.1 million (see NOTE 8). In December 2013 the Company simplified its capital structure by dissolving the trusts and distributing the related junior subordinated notes (originally issued to the trusts by the Company) to the holders of the trusts' common and preferred securities. Prior to dissolution, the Company's equity in the earnings of the trusts consisted solely of the common trust securities' pro rata share in interest accruing on junior subordinated notes issued to the trusts.

NOTE 6 ¾ REPURCHASE ARRANGEMENTS AND SIMILAR BORROWINGS

Capstead pledges its Residential mortgage investments as collateral under repurchase arrangements with commercial banks and other financial institutions, referred to as counterparties, the terms and conditions of which are negotiated on a transaction-by-transaction basis when each such borrowing is initiated or renewed. Repurchase arrangements entered into by the Company involve the sale and a simultaneous agreement to repurchase the transferred assets at a future date, typically with terms of 30 to 90 days, and are accounted for as borrowings. The Company maintains the beneficial interest in the specific securities pledged during the borrowing's term of the repurchase arrangement and receives the related principal and interest payments. The amount borrowed is generally equal to the fair value of the assets pledged, as determined by the lending counterparty, less an agreed-upon discount, referred to as a "haircut." Interest rates on these borrowings are fixed based on prevailing rates corresponding to the terms of the borrowings, and interest is paid at the termination of the repurchase arrangement at which time the Company may enter into a new repurchase arrangement at prevailing haircuts and rates with the same counterparty or repay that counterparty and negotiate financing with a different counterparty. None of the Company's counterparties are obligated to renew or otherwise enter into new repurchase arrangements at the conclusion of existing repurchase arrangements. In response to declines in fair value of pledged securities due to changes in market conditions or the publishing of monthly security pay down factors, lenders typically require the Company to post additional securities as collateral, pay down borrowings or fund cash margin accounts with the counterparties in order to re-establish the agreed-upon collateral requirements. These actions are referred to as margin calls. Conversely, in response to increases in fair value of pledged securities, the Company routinely margin calls its lending counterparties in order to release posted collateral.

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Repurchase arrangements and similar borrowings (and related pledged collateral, including accrued interest receivable), classified by collateral type and remaining maturities, and related weighted average borrowing rates as of the indicated dates were as follows (dollars in thousands):

Collateral Type	Collateral Carrying Amount	Accrued Interest Receivable	Borrowings Outstanding	Average Borrowing Rates	
September 30, 2014					
Borrowings with maturities of 30 days or less:					
Agency Securities	$11,007,943	$ 22,583	$10,471,646	0.30	%
Borrowings with maturities greater than 30 days:					
Agency Securities (31 to 90 days)	519,510	1,099	497,530	0.31	
Agency Securities (greater than 90 days)	1,870,094	3,927	1,778,517	0.52	
Similar borrowings:					
Collateral for structured financings*	2,069	–	2,069	8.10	
	$13,399,616	$ 27,609	$12,749,762	0.33	
Quarter-end borrowing rates adjusted for effects of related derivative financial instruments (“Derivatives”) held as cash flow hedges (see NOTE 7)				0.52	
December 31, 2013					
Borrowings with maturities of 30 days or less:					
Agency Securities	$12,169,534	$ 28,195	$11,578,211	0.38	%
Borrowings with maturities greater than 30 days:					
Agency Securities (31 to 90 days)	951,966	2,068	902,432	0.38	
Similar borrowings:					
Collateral for structured financings*	2,257	–	2,257	8.09	
	$13,123,757	$ 30,263	$12,482,900	0.38	
Quarter-end borrowing rates adjusted for effects of related Derivatives held as cash flow hedges				0.49	

* The maturity of structured financings is directly affected by prepayments on the related mortgage pass-through securities pledged as collateral. Additionally, these financings are subject to redemption by the residual bondholders.

Average borrowings outstanding differed from respective quarter-end balances during the indicated periods primarily due to changes in portfolio levels and differences in the timing of portfolio acquisitions relative to portfolio runoff as illustrated below (dollars in thousands):

	Quarter Ended					
	September 30, 2014			December 31, 2013		
	Average Borrowings	Average Rate		Average Borrowings	Average Rate	
Average borrowings and rates adjusted for the effects of related Derivatives held as cash flow hedges for the indicated quarters	$12,690,463	0.51	%	$12,510,701	0.49	%

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NOTE 7 ¾ USE OF DERIVATIVE FINANCIAL INSTRUMENTS, OFFSETTING DISCLOSURES AND CHANGES IN OTHER COMPREHENSIVE INCOME BY COMPONENT

To help mitigate exposure to higher interest rates, Capstead typically uses currently-paying and forward-starting, one-month LIBOR-indexed, pay-fixed, receive-variable, interest rate swap agreements that require interest payments for two-year terms. These Derivatives are designated as cash flow hedges of the variability of the underlying benchmark interest rate of current and forecasted 30- to 90-day borrowings under repurchase arrangements. This hedge relationship establishes a relatively stable fixed rate on related borrowings because the variable-rate payments received on the swap agreements offset a significant portion of the interest accruing on the related borrowings, leaving the fixed-rate swap payments as the Company’s effective borrowing rate, subject to certain adjustments. These adjustments include differences between variable rate payments received on the swap agreements and related unhedged borrowing rates as well as the effects of measured hedge ineffectiveness. Additionally, changes in fair value of these Derivatives tend to partially offset opposing changes in fair value of the Company’s residential mortgage investments that can occur in response to changes in market interest rates.

During the quarter and nine months ended September 30, 2014 Capstead entered into new forward-starting swap agreements with notional amounts totaling $500 million and $1.90 billion, respectively. These swap agreements require fixed rate interest payments averaging 0.72% and 0.61%, respectively, for two-year periods commencing on various dates between April 2014 and January 2015. Also during these periods, $200 million and $800 million notional amount of swaps requiring fixed rate interest payments averaging 0.51% and 0.53%, respectively, matured, while $700 million and $3.50 billion notional amount of previously-acquired, forward-starting swaps requiring fixed rate interest payments averaging 0.56% and 0.51%, respectively, moved into current-pay status. At September 30, 2014, the Company’s portfolio of financing-related swap positions had the following characteristics (dollars in thousands):

Period of Contract Expiration	Notional Amount	Average Fixed Rate Payment Requirement	
Currently-paying contracts:			
Fourth quarter 2014	$500,000	0.58	%
First quarter 2015	1,100,000	0.50	
Second quarter 2015	200,000	0.43	
Third quarter 2015	400,000	0.47	
Fourth quarter 2015	1,200,000	0.45	
First quarter 2016	1,700,000	0.51	
Second quarter 2016	1,100,000	0.47	
Third quarter 2016	700,000	0.56	
(average expiration: 13 months)	6,900,000	0.50	
Forward-starting contracts:			
Fourth quarter 2016	800,000	0.66	
First quarter 2017	100,000		