

ANWORTH MORTGAGE ASSET CORP

Form 10-K

March 12, 2008

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

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2007**

OR

.. **TRANSACTION REPORT PURSUANT TO SECTION 13 OR 15 OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO**

COMMISSION FILE NUMBER 001-13709

ANWORTH MORTGAGE ASSET CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

MARYLAND
(State or Other Jurisdiction of Incorporation Organization)

52-2059785
(I.R.S. Employer Identification No.)

1299 OCEAN AVENUE, 2ND FLOOR, SANTA MONICA, CALIFORNIA 90401
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (310) 255-4493

Securities registered pursuant to Section 12(b) of the Act:

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Title of Each Class	Name of Exchange on Which Registered
Series A Cumulative Preferred Stock, \$0.01 Par Value	New York Stock Exchange
Series B Cumulative Convertible Preferred Stock, \$0.01 Par Value	New York Stock Exchange
Common Stock, \$0.01 Par Value	New York Stock Exchange
Securities registered pursuant to Section 12(g) of the Act: NONE	

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant is a well-known seasoned issuer as defined in Rule 405 of the Act. Yes ☐ No ☒

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 filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark that disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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 definitions of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one):

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 Act). Yes ☐ No ☒

The aggregate market value of the voting stock held by non-affiliates of the registrant, computed by reference to the average closing bid and asked prices of such stock, as of June 29, 2007 was approximately \$387,015,829 (All officers and directors of the registrant are considered affiliates).

At March 7, 2008, the registrant had 1,875,500 shares of Series A Cumulative Preferred Stock issued and outstanding; 1,206,000 shares of Series B Cumulative Convertible Preferred Stock issued and outstanding; and 75,785,231 shares of Common Stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of the Form 10-K incorporates by reference certain portions of the registrant's proxy statement for its 2008 annual meeting of stockholders to be filed with the Commission not later than 120 days after the end of the fiscal year covered by this report.

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ANWORTH MORTGAGE ASSET CORPORATION

FORM 10-K ANNUAL REPORT

FISCAL YEAR ENDED DECEMBER 31, 2007

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CAUTIONARY STATEMENT

This Annual Report on Form 10-K contains or incorporates by reference certain forward-looking statements. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. You can generally identify forward-looking statements as statements containing the words will, believe, expect, anticipate, intend, estimate, assume or other similar expressions. You should not rely on our forward-looking statements because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. These forward-looking statements are subject to assumptions that are difficult to predict and to various risks and uncertainties. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors, some of which are listed under the section Risk Factors at the end of Item 1A of this Annual Report on Form 10-K. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

As used in this Annual Report on Form 10-K, company, we, us, our and Anworth refer to Anworth Mortgage Asset Corporation.

PART I

Item 1. BUSINESS
Overview

We were formed in October 1997 and commenced operations on March 17, 1998. We are in the business of investing primarily in mortgage-related assets including mortgage pass-through certificates, collateralized mortgage obligations (CMOs), mortgage loans and other securities representing interests in, or obligations backed by, pools of mortgage loans which can be readily financed. Our principal business objective is to generate net income for distribution to stockholders based upon the spread between the interest income on our mortgage-related assets and the costs of borrowing to finance our acquisition of these assets.

We are organized for tax purposes as a REIT. Accordingly, we generally distribute substantially all of our earnings to stockholders without paying federal or state income tax at the corporate level on the distributed earnings. At December 31, 2007, our qualified REIT assets (real estate assets, as defined under the Internal Revenue Code of 1986, or the Code, cash and cash items and government securities) were greater than 90% of our total assets, as compared to the Code requirement that at least 75% of our total assets must be qualified REIT assets. Greater than 99% of our 2007 revenue qualifies for both the 75% source of income test and the 95% source of income test under the REIT rules. We believe we met all REIT requirements regarding the ownership of our common stock and the distributions of our net income. Therefore, we believe that we continue to qualify as a REIT under the provisions of the Code.

Our continuing operations consist of the following portfolios: Agency mortgage-backed securities, or Agency MBS, and Non-Agency mortgage-backed securities, or Non-Agency MBS. Our discontinued operations consisted of the following portfolios: Belvedere Trust's residential real estate loans, or BT Residential Loans, and Belvedere Trust's other mortgage-backed securities, or BT Other MBS.

In November 2003, we formed Belvedere Trust Mortgage Corporation, or Belvedere Trust, to acquire mortgage loans and other mortgage-related assets. Through May 2005, Belvedere Trust securitized a substantial amount of those mortgage loans and retained a portion of the MBS while selling the balance to third parties in the secondary market. Since 2005, Belvedere Trust invested in senior and subordinated tranches from other issuers' securitizations.

Due to recent liquidity and credit problems surrounding the mortgage markets generally, Belvedere Trust received, during the third quarter of 2007, margin calls from its lenders that it was unable to meet, resulting in defaults under lines of credit. On September 5, 2007, following discussions with financial advisers retained by

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Belvedere Trust in connection with the issues facing the credit markets, it was determined that obtaining alternate financing for Belvedere Trust was unlikely and we concluded that a material charge for impairment with respect to all of Belvedere Trust's assets was required under generally accepted accounting principles, or GAAP. In September 2007, we developed a plan to dispose of Belvedere Trust. In December 2007, Belvedere Trust received several notices of default from its remaining counterparties which it was unable to meet and, as a result, its remaining assets were either seized or written off. Belvedere Trust, which is reported as a discontinued operation in the financial statements included in this Annual Report on Form 10-K, has three claims against it totaling approximately \$8 million, which have been contested, relating to repurchase agreement transactions. Anworth is neither a co-party to nor a guarantor of Belvedere Trust's repurchase agreements or any claims against Belvedere Trust.

At December 31, 2007, we had total assets of \$4.8 billion. Our Agency MBS portfolio, consisting of \$4.7 billion, was distributed as follows: 20% agency adjustable-rate MBS, 62% agency hybrid adjustable-rate MBS, 18% agency fixed-rate MBS and less than 1% agency floating-rate CMOs. Our Non-Agency MBS portfolio consisted of \$43 million of floating-rate CMOs. Stockholders' equity available to common stockholders at December 31, 2007 was approximately \$352.5 million, or \$6.15 per share. The \$352.5 million equals total stockholders' equity of \$401.4 million less the Series A Cumulative Preferred Stock, or Series A Preferred Stock, liquidating value of \$46.9 million and less the difference between the Series B Cumulative Convertible Preferred Stock, or Series B Preferred Stock, liquidating value of \$30.1 million and the proceeds from its sale of \$28.1 million. For the year ended December 31, 2007, we reported a net loss of \$156.5 million. Net loss to common stockholders was \$161.2 million, or a net loss of \$(3.47) per diluted share. This includes a loss of approximately \$23.4 million on the sale of Agency MBS and Non-Agency MBS and a net loss on discontinued operations of approximately \$151.3 million. The net loss on discontinued operations includes three claims against Belvedere Trust totaling approximately \$8 million, which have been contested, relating to repurchase agreement transactions. Anworth is neither a co-party to nor a guarantor of Belvedere Trust's repurchase agreements or any claims against Belvedere Trust. Relative to the contested claims, we believe that there will be an increase to earnings after the dissolution of Belvedere Trust, although there can be no assurances as to the timing of such dissolution.

Our Strategy

Investment Strategy

Our strategy is to invest primarily in United States agency and other highly rated single-family adjustable-rate and fixed-rate MBS and other mortgage-related assets. We seek to acquire assets that will produce competitive returns after considering the amount and nature of the investment's anticipated returns, our ability to pledge the investment to secure collateralized borrowings and the costs associated with financing, managing, securitizing and reserving for these investments. We do not currently originate mortgage loans or provide other types of financing to the owners of real estate.

Financing Strategy

We primarily finance the acquisition of MBS with short-term borrowings and, to a lesser extent, equity capital. We employ short-term borrowing to attempt to increase potential returns to our stockholders. Pursuant to our Capital and Leverage Policy, we seek to strike a balance between the under-utilization of leverage, which reduces potential returns to stockholders, and the over-utilization of leverage, which could reduce our ability to meet our obligations during adverse market conditions.

We usually borrow at short-term rates using repurchase agreements. Repurchase agreements are generally short-term in nature with a maximum term of typically two years. We actively manage the adjustment periods and the selection of the interest rate indices of our borrowings against the adjustment periods and the selection of indices on our mortgage-related assets in order to lessen the liquidity and interest rate-related risks. We generally

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seek to diversify our exposure by entering into repurchase agreements with multiple lenders which we believe are financially sound and are approved by our board of directors.

Growth Strategy

It is our long-term objective to further grow our earnings and our dividends per common share using various strategies which may include the following:

decreasing the ratio of operating expenses to stockholder equity by increasing the amount of our stockholder equity at a rate faster than the rate of increase in our operating expenses;

issuing additional common shares when the net proceeds will materially increase the paid-in capital per share and the book value per share;

repurchasing outstanding common shares when the net cost will materially increase the paid-in capital per share and the book value per share; and

lowering our effective borrowing costs over time by seeking direct funding with collateralized lenders rather than using financial intermediaries and possibly using commercial paper, medium-term note programs, preferred stock and other forms of capital.

Our Operating Policies and Programs

We have established the following four primary operating policies to implement our business strategies:

our Asset Acquisition Policy;

our Capital and Leverage Policy;

our Credit Risk Management Policy; and

our Asset/Liability Management Policy.

Asset Acquisition Policy

Our Asset Acquisition Policy provides guidelines for acquiring investments and contemplates that we will acquire a portfolio of investments that can be grouped into specific categories. Each category and our respective investment guidelines are as follows:

Category I At least 60% of our total assets will generally be adjustable- or fixed-rate MBS and short-term investments. Assets in this category will be rated within one of the two highest rating categories by at least one nationally recognized statistical rating organization or, if not rated, will be obligations guaranteed by the United States government or its agencies, such as Fannie Mae or Freddie Mac. Also included in Category I are the portion of real estate mortgage loans that have been deposited into a trust and have received a rating within one of the two highest rating categories by at least one nationally recognized statistical rating organization.

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Category II At least 90% of our total assets will generally consist of Category I investments plus unsecuritized mortgage loans, mortgage securities rated at least investment grade by at least one nationally recognized statistical rating organization, or shares of other REITs or mortgage-related companies and the portion of real estate mortgage loans that have been deposited into a trust and have received an investment grade rating by at least one nationally recognized statistical rating organization.

Category III No more than 10% of our total assets may be of a type not meeting any of the above criteria. Among the types of assets generally assigned to this category are mortgage securities rated below investment grade and leveraged mortgage derivative securities. Under our Category III investment criteria, we may acquire other types of mortgage derivative securities including, but not limited to, interest-only, principal-only or other types of MBS that receive a disproportionate share of interest income or principal.

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Capital and Leverage Policy

We employ a leverage strategy to increase our investment assets by borrowing against existing mortgage-related assets and using the proceeds to acquire additional mortgage-related assets. Relative to our investment in investment grade Agency MBS, we generally borrow, on a short-term basis, between eight to twelve times the amount of our equity allocated to these investments. Our borrowings may vary from time to time depending on market conditions and other factors deemed relevant by our management and our board of directors. We believe that this will leave an adequate capital base to protect against interest rate environments in which our borrowing costs might exceed our interest income from mortgage-related assets. We enter into collateralized borrowings with major lending institutions which we believe are financially sound and are approved by our board of directors.

Depending on the different costs of borrowing funds at different maturities, we may vary the maturities of our borrowed funds in an attempt to produce lower borrowing costs. Our borrowings are short-term and we manage actively, on an aggregate basis, both the interest rate indices and interest rate adjustment periods of our borrowings against the interest rate indices and interest rate adjustment periods on our mortgage-related assets.

Our mortgage-related assets are financed primarily at short-term borrowing rates through repurchase agreements and dollar-roll agreements. In the future, we may also employ borrowings under lines of credit and other collateralized financings that we may establish with approved institutional lenders.

Credit Risk Management Policy

We review credit risk and other risks of loss associated with each of our potential investments. In addition, we may diversify our portfolio of mortgage-related assets to avoid undue geographic, insurer, industry and certain other types of concentrations.

Compliance with our Credit Risk Management Policy guidelines is determined at the time of purchase of mortgage assets based upon the most recent valuation utilized by us. Such compliance is not affected by events subsequent to such purchase including, without limitation, changes in characterization, value or rating of any specific mortgage assets or economic conditions or events generally affecting any mortgage-related assets of the type held by us.

Asset/Liability Management Policy

Interest Rate Risk Management. To the extent consistent with our election to qualify as a REIT, we follow an interest rate risk management program intended to protect our portfolio of mortgage-related assets and related debt against the effects of major interest rate changes. Specifically, our interest rate management program is formulated with the intent to offset, to some extent, the potential adverse effects resulting from rate adjustment limitations on our mortgage-related assets and the differences between interest rate adjustment indices and interest rate adjustment periods of our adjustable-rate mortgage-related assets and related borrowings.

Our interest rate risk management program encompasses a number of procedures including the following:

monitoring and adjusting, if necessary, the interest rate sensitivity of our mortgage-related assets compared with the interest rate sensitivities of our borrowings;

attempting to structure our borrowing agreements relating to adjustable-rate mortgage-related assets to have a range of different maturities and interest rate adjustment periods (although substantially all will be less than one year); and

actively managing, on an aggregate basis, the interest rate indices and interest rate adjustment periods of our mortgage-related assets compared to the interest rate indices and adjustment periods of our borrowings.

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We expect to be able to adjust the average maturity/adjustment period of our borrowings on an ongoing basis by changing the mix of maturities and interest rate adjustment periods as borrowings come due or are renewed. Through the use of these procedures, we attempt to reduce the risk of differences between interest rate adjustment periods of our adjustable-rate mortgage-related assets and our related borrowings.

Depending on market conditions and the cost of the transactions, we may conduct certain hedging activities in connection with the management of our portfolio. To the extent consistent with our election to qualify as a REIT, we may adopt a hedging strategy intended to lessen the effects of interest rate changes and to enable us to earn net interest income in periods of generally rising, as well as declining or static, interest rates. Specifically, hedging programs are formulated with the intent to offset some of the potential adverse effects of changes in interest rate levels relative to the interest rates on the mortgage-related assets held in our investment portfolio and differences between the interest rate adjustment indices and periods of our mortgage-related assets and our borrowings. We monitor carefully, and may have to limit, our asset/liability management program to assure that we do not realize excessive hedging income or hold hedges having excess value in relation to mortgage-related assets, which could result in our disqualification as a REIT or, in the case of excess hedging income, if the excess is due to reasonable cause and not willful neglect, the payment of a penalty tax for failure to satisfy certain REIT income tests under the Code. In addition, asset/liability management involves transaction costs that increase dramatically as the period covered by hedging protection increases and that may increase during periods of fluctuating interest rates.

Prepayment Risk Management. We also seek to lessen the effects of prepayment of mortgage loans underlying our securities at a faster or slower rate than anticipated. We accomplish this by structuring a diversified portfolio with a variety of prepayment characteristics, investing in mortgage-related assets with prepayment prohibitions and penalties, investing in certain mortgage security structures that have prepayment protections and purchasing mortgage-related assets at a premium or at a discount. We invest in mortgage-related assets that, on a portfolio basis, do not have significant purchase price premiums. Under normal market conditions, we seek to maintain the aggregate capitalized purchase premium of the portfolio at 3% or less. In addition, we can purchase principal-only derivatives to a limited extent as a hedge against prepayment risks. We monitor prepayment risk through periodic review of the impact of a variety of prepayment scenarios on our revenues, net earnings, dividends, cash flow and net consolidated balance sheets market value.

We believe that we have developed cost-effective asset/liability management policies to mitigate prepayment risks. However, no strategy can completely insulate us from prepayment risks. Further, as noted above, certain of the federal income tax requirements that we must satisfy to qualify as a REIT limit our ability to fully hedge our prepayment risks. Therefore, we could be prevented from effectively hedging our interest rate and prepayment risks.

Our Investments

Mortgage-Backed Securities (MBS)

Pass-Through Certificates. We principally invest in pass-through certificates, which are securities representing interests in pools of mortgage loans secured by residential real property in which payments of both interest and principal on the securities are generally made monthly, in effect, passing through monthly payments made by the individual borrowers on the mortgage loans which underlie the securities, net of fees paid to the issuer or guarantor of the securities. Early repayment of principal on some MBS, arising from prepayments of principal due to sale of the underlying property, refinancing or foreclosure, net of fees and costs which may be incurred, may expose us to a lower rate of return upon reinvestment of principal. This is generally referred to as prepayment risk. Additionally, if a security subject to prepayment has been purchased at a premium, the unamortized value of the premium would be lost in the event of prepayment.

Like other fixed-income securities, when interest rates rise, the value of a mortgage-backed security generally will decline. When interest rates are declining, however, the value of MBS with prepayment features

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may not increase as much as other fixed-income securities. The rate of prepayments on underlying mortgages will affect the price and volatility of MBS and may have the effect of shortening or extending the effective maturity of the security beyond what was anticipated at the time of purchase. When interest rates rise, our holdings of MBS may experience reduced returns if the owners of the underlying mortgages pay off their mortgages later than anticipated. This is generally referred to as extension risk.

Payment of principal and interest on some mortgage pass-through securities, though not the market value of the securities themselves, may be guaranteed by the full faith and credit of the federal government, including securities backed by Ginnie Mae, or by agencies or instrumentalities of the federal government, including Fannie Mae and Freddie Mac. MBS created by non-governmental issuers, including commercial banks, savings and loan institutions, private mortgage insurance companies, mortgage bankers and other secondary market issuers, may be supported by various forms of insurance or guarantees including individual loan, title, pool and hazard insurance and letters of credit which may be issued by governmental entities, private insurers or the mortgage poolers.

Collateralized Mortgage Obligations. CMOs are MBS. Interest and principal on a CMO are paid, in most cases, on a monthly basis. CMOs may be collateralized by whole mortgage loans, but are more typically collateralized by portfolios of mortgage pass-through securities. CMOs are structured into multiple classes with each class bearing a different stated maturity. Monthly payments of principal, including prepayments, are first returned to investors holding the shortest maturity class; investors holding the longer maturity classes receive principal only after the first class has been retired. We will typically consider CMOs that are issued or guaranteed by the federal government, or by any of its agencies or instrumentalities, to be United States government securities.

Other Types of MBS

Mortgage Derivative Securities. We may acquire mortgage derivative securities in an amount not to exceed 10% of our total assets. Mortgage derivative securities provide for the holder to receive interest-only, principal-only or interest and principal in amounts that are disproportionate to those payable on the underlying mortgage loans. Payments on mortgage derivative securities are highly sensitive to the rate of prepayments on the underlying mortgage loans. In the event of faster or slower than anticipated prepayments on these mortgage loans, the rates of return on interests in mortgage derivative securities, representing the right to receive interest-only or a disproportionately large amount of interest or interest-only derivatives, would be likely to decline or increase, respectively. Conversely, the rates of return on mortgage derivative securities, representing the right to receive principal-only or a disproportionate amount of principal or principal-only derivatives, would be likely to increase or decrease in the event of faster or slower prepayments, respectively.

We may invest in inverse floaters, a class of CMOs with a coupon rate that resets in the opposite direction from the market rate of interest to which it is indexed, including LIBOR or the 11th District Cost of Funds Index, or COFI. Any rise in the index rate, which can be caused by an increase in interest rates, causes a drop in the coupon rate of an inverse floater, while any drop in the index rate causes an increase in the coupon of an inverse floater. An inverse floater may behave like a leveraged security since its interest rate usually varies by a magnitude much greater than the magnitude of the index rate of interest. The leverage-like characteristics inherent in inverse floaters result in a greater volatility of their market prices.

We may invest in other mortgage derivative securities that may be developed in the future.

Subordinated Interests. We may acquire subordinated interests, which are classes of MBS that are junior to other classes of the same series of MBS in the right to receive payments from the underlying mortgage loans. The subordination may be for all payment failures on the mortgage loans securing or underlying such series of mortgage securities. The subordination will not be limited to those resulting from particular types of risks, including those resulting from war, earthquake or flood, or the bankruptcy of a borrower. The subordination may be for the entire amount of the series of mortgage-related securities or may be limited in amount.

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Mortgage Warehouse Participations. We may occasionally acquire mortgage warehouse participations as an additional means of diversifying our sources of income. We anticipate that these investments, together with our investments in other Category III assets, will not in the aggregate exceed 10% of our total mortgage-related assets. These investments are participations in lines of credit to mortgage loan originators secured by recently originated mortgage loans that are in the process of being sold to investors. Our investments in mortgage warehouse participations are limited because they are not qualified REIT assets under the Code.

Other Mortgage-Related Assets

We may acquire other investments that include equity and debt securities issued by other primarily mortgage-related finance companies, interests in mortgage-related collateralized bond obligations, other subordinated interests in pools of mortgage-related assets, commercial mortgage loans and securities and residential mortgage loans other than high-credit quality mortgage loans. Although we expect that our other investments will be limited to less than 10% of total assets, we have no limit on how much of our stockholders' equity will be allocated to other investments. There may be periods in which other investments represent a large portion of our stockholders' equity.

Competition

When we invest in MBS, mortgage loans and other investment assets, we compete with a variety of institutional investors including other REITs, insurance companies, mutual funds, pension funds, investment banking firms, banks and other financial institutions that invest in the same types of assets. Many of these investors have greater financial resources and access to lower costs of capital than we do.

Employees

As of December 31, 2007, Anworth had twelve employees, seven of whom were part-time, and BT Management had two part-time employees who performed substantially all of their duties for Belvedere Trust.

Company Information

We were incorporated in Maryland on October 20, 1997 and commenced our operations on March 17, 1998. Our principal executive offices are located at 1299 Ocean Avenue, 2nd Floor, Santa Monica, California, 90401. Our telephone number is (310) 255-4493 and our fax number is (310) 434-0070.

Information on our Company Web Site

Our web site address is www.anworth.com. We make our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports available, free of charge, on our web site as soon as reasonably practicable after we file these reports with the Securities and Exchange Commission, or the SEC. In addition, we post the following information on our web site (the information on our web site is not a part of this Annual Report on Form 10-K):

our corporate code of conduct, which qualifies as a code of ethics as defined by Item 406 of Regulation S-K of the Securities Exchange Act of 1934;

our corporate governance guidelines; and

charters for our Audit Committee, Nominating and Corporate Governance Committee and Compensation Committee.

All of the above information is also available in print upon request to our secretary at the address listed under the heading "Company Information" above.

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CERTAIN FEDERAL INCOME TAX CONSIDERATIONS

The following discussion summarizes particular United States federal income tax considerations regarding our qualification and taxation as a REIT and particular United States federal income tax consequences resulting from the acquisition, ownership and disposition of our capital stock. This discussion is based on current law and assumes that we have qualified at all times throughout our existence, and will continue to qualify, as a REIT for United States federal income tax purposes. The tax law upon which this discussion is based could be changed and any such change could have a retroactive effect. The following discussion is not exhaustive of all possible tax considerations. This summary neither gives a detailed discussion of any state, local or foreign tax considerations nor discusses all of the aspects of United States federal income taxation that may be relevant to you in light of your particular circumstances or to particular types of stockholders which are subject to special tax rules, such as insurance companies, tax-exempt entities, financial institutions or broker-dealers, foreign corporations or partnerships and persons who are not citizens or residents of the United States, stockholders that hold our stock as a hedge, part of a straddle, conversion transaction or other arrangement involving more than one position, or stockholders whose functional currency is not the United States dollar. This discussion assumes that you will hold our capital stock as a capital asset, generally property held for investment, under the Code.

In reading the federal income tax disclosure below, it should be noted that although Anworth is combined with all of its wholly-owned subsidiaries for financial accounting and reporting purposes, for federal income tax purposes, only Anworth and its wholly-owned subsidiaries, Belvedere Trust, BT Management Holding Corporation, Belvedere Trust Secured Assets Corporation and BellaVista Finance Corporation, constitute the REIT. Anworth's remaining wholly-owned subsidiaries, Belvedere Trust Finance Corporation, or BT Finance, BT Residential Funding Corporation and BellaVista Funding Corporation, constitute a separate consolidated group subject to regular income taxes.

We urge you to consult with your own tax advisor regarding the specific consequences to you of the acquisition, ownership and disposition of stock in an entity electing to be taxed as a REIT, including the federal, state, local, foreign and other tax considerations of such acquisition, ownership, disposition and election and the potential changes in applicable tax laws.

General

Our qualification and taxation as a REIT depends upon our ability to continue to meet the various qualification tests, imposed under the Code and discussed below, relating to our actual annual operating results, asset diversification, distribution levels and diversity of stock ownership. Accordingly, the actual results of our operations for any particular taxable year may not satisfy these requirements.

We have made an election to be taxed as a REIT under the Code commencing with our taxable year ended December 31, 1998. We currently expect to continue operating in a manner that will permit us to maintain our qualification as a REIT. All qualification requirements for maintaining our REIT status, however, may not have been, or will not continue to be, met.

So long as we qualify for taxation as a REIT, we generally will be permitted a deduction for dividends we pay to our stockholders. As a result, we generally will not be required to pay federal corporate income taxes on our net income that is currently distributed to our stockholders. This treatment substantially eliminates the double taxation that ordinarily results from investment in a corporation. Double taxation means taxation once at the corporate level when income is earned and once again at the stockholder level when this income is distributed. We will be required to pay federal income tax, however, as follows:

we will be required to pay tax at regular corporate rates on any undistributed real estate investment trust taxable income, including undistributed net capital gains;

we may be required to pay the alternative minimum tax on our items of tax preference; and

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if we have (a) net income from the sale or other disposition of foreclosure property which is held primarily for sale to customers in the ordinary course of business, or (b) other non-qualifying income from foreclosure property, we will be required to pay tax at the highest corporate rate on this income. Foreclosure property is generally defined as property acquired through foreclosure or after a default on a loan secured by the property or on a lease of the property.

To the extent that distributions exceed current and accumulated earnings and profits, they will constitute a return of capital, rather than dividend or capital gain income, and will reduce the basis for the stockholder's stock with respect to which the distributions are paid or, to the extent that they exceed such basis, will be taxed in the same manner as gain from the sale of that stock. For purposes of determining whether distributions are out of current or accumulated earnings and profits, our earnings and profits will be allocated first to our preferred stock (as compared to distributions with respect to our common stock) so that distributions with respect to our preferred stock are more likely to be treated as dividends than as return of capital or a distribution in excess of basis.

Dividends paid by regular C corporations to stockholders other than corporations now are generally taxed at the rate applicable to long-term capital gains, which is a maximum of 15%, subject to certain limitations. Because we are a REIT, however, our dividends, including dividends paid on our Series A Preferred Stock and Series B Preferred Stock, generally will continue to be taxed at regular ordinary income tax rates, except in limited circumstances.

We will be required to pay a 100% tax on any net income from prohibited transactions. Prohibited transactions are, in general, sales or other taxable dispositions of property other than foreclosure property held primarily for sale to customers in the ordinary course of business. Under existing law, whether property is held as inventory or primarily for sale to customers in the ordinary course of a trade or business depends on all the facts and circumstances surrounding the particular transaction.

If we fail to satisfy the 75% gross income test or the 95% gross income test discussed below but nonetheless maintain our qualification as a REIT because certain other requirements are met, we will be subject to a tax equal to:

the greater of (i) the amount by which 75% of our gross income exceeds the amount qualifying under the 75% gross income test described below, and (ii) the amount by which 95% of our gross income exceeds the amount qualifying under the 95% gross income test described below, multiplied by a fraction intended to reflect our profitability.

In the event of more than de minimis failure of any of the asset tests occurs in a taxable year, as long as the failure was due to reasonable cause and not to willful neglect and we dispose of the assets or otherwise comply with the asset tests within six months after the last day of the quarter in which we identify such failure, we will pay a tax equal to the greater of \$50 thousand or 35% of the net income from the non-qualifying assets during the period in which we failed to satisfy any of the asset tests.

In the event of a failure to satisfy one or more requirements for REIT qualification occurring in a taxable year, other than the gross income tests and the asset tests, as long as such failure was due to reasonable cause and not to willful neglect, we will be required to pay a penalty of \$50 thousand for each such failure.

We will be required to pay a nondeductible 4% excise tax on the excess of the required distribution over the amounts actually distributed if we fail to distribute during each calendar year at least the sum of:

85% of our real estate investment trust ordinary income for the year;

95% of our real estate investment trust capital gain net income for the year; and

any undistributed taxable income from prior periods.

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This distribution requirement is in addition to, and different from, the distribution requirements discussed below in the section entitled Annual Distribution Requirements.

We may elect to retain and pay income tax on our net long-term capital gain. In that case, a United States stockholder would be taxed on its proportionate share of our undistributed long-term capital gain (to the extent that we make a timely designation of such gain to the stockholder) and would receive a credit or refund of its proportionate share of the tax we paid. The basis of the stockholder's shares is increased by the amount of the undistributed long-term capital gain (less the amount of capital gains tax paid by the REIT) included in the stockholder's long-term capital gains.

If we own a residual interest in a REMIC, we will be taxable at the highest corporate rate on the portion of any excess inclusion income that we derive from the REMIC residual interests equal to the percentage of our stock that is held by disqualified organizations. Although the law is unclear, similar rules may apply if we own an equity interest in a taxable mortgage pool. To the extent that we own a REMIC residual interest in a taxable mortgage pool through a taxable REIT subsidiary, we will not be subject to tax. A disqualified organization includes:

the United States;

any state or political subdivision of the United States;

any foreign government;

any international organization;

any agency or instrumentality of any of the foregoing;

any other tax-exempt organization other than a farmers' cooperative described in Section 521 of the Code that is exempt both from income taxation and from taxation under the unrelated business taxable income provisions of the Code; and

any rural electrical or telephone cooperative.

If we acquire any asset from a corporation which is or has been taxed as a C corporation under the Code in a transaction in which the basis of the asset in our hands is determined by reference to the basis of the asset in the hands of the C corporation and we subsequently recognize gain on the disposition of the asset during the ten-year period beginning on the date on which we acquired the asset, then we will be required to pay tax at the highest regular corporate tax rate on this gain to the extent of the excess of:

the fair market value of the asset, over

our adjusted basis in the asset,

in each case determined as of the date on which we acquired the asset.

A C corporation is generally defined as a corporation required to pay full corporate-level tax. The results described in the preceding paragraph with respect to the recognition of gain will apply unless we make an election under Treasury Regulation Section 1.337(d)-7(c). If such an election were made, the C corporation would recognize taxable gain or loss as if it had sold the assets we acquired from the C corporation to an

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unrelated third party at fair market value on the acquisition date.

We will be subject to a 100% excise tax if our dealings with any taxable REIT subsidiaries (defined below) are not at arm's length.

In addition, notwithstanding our REIT status, we may also have to pay certain state and local income taxes, because not all states and localities treat REITs in the same manner as they are treated for federal income tax purposes.

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Requirements for Qualification as a REIT

The Code defines a REIT as a corporation, trust or association:

1. that is managed by one or more trustees or directors;
2. that issues transferable shares or transferable certificates to evidence beneficial ownership;
3. that would be taxable as a domestic corporation but for tax code Sections 856 through 859;
4. that is not a financial institution or an insurance company within the meaning of the Code;
5. that is beneficially owned by 100 or more persons;
6. that not more than 50% in value of the outstanding stock of which is owned, actually or constructively, by five or fewer individuals, including specified entities, during the last half of each taxable year;
7. that meets other tests, described below, regarding the nature of its income and assets and the amount of its distributions; and
8. that elects to be a REIT or has made such election for a previous taxable year and satisfies all relevant filing and other administrative requirements established by the Internal Revenue Service, or the IRS, that must be met to elect and retain REIT status.

The Code provides that all of the first four conditions stated above must be met during the entire taxable year and that the fifth condition must be met during at least 335 days of a taxable year of twelve months, or during a proportionate part of a taxable year of less than twelve months. The fifth and sixth conditions do not apply until after the first taxable year for which an election is made to be taxed as a REIT.

For purposes of the sixth condition, pension trusts and other specified tax-exempt entities generally are treated as individuals, except that a look-through exception generally applies with respect to pension funds.

Stock Ownership Tests

Our stock must be beneficially held by at least 100 persons, the 100 Stockholder Rule, and no more than 50% of the value of our stock may be owned, directly or indirectly, by five or fewer individuals at any time during the last half of the taxable year, the 5/50 Rule. For purposes of the 100 Stockholder Rule only, trusts described in Section 401(a) of the Code and exempt under Section 501(a) of the Code are generally treated as persons. These stock ownership requirements must be satisfied in each taxable year other than the first taxable year for which an election is made to be taxed as a REIT. We are required to solicit information from certain of our record stockholders to verify actual stock ownership levels and our charter provides for restrictions regarding the transfer of our stock in order to aid in meeting the stock ownership requirements. If we were to fail either of the stock ownership tests, we would generally be disqualified from our REIT status. However, if we comply with regulatory rules pursuant to which we are required to send annual letters to holders of our stock requesting information regarding the actual ownership of our stock, and we do not know, or exercising reasonable diligence would not have known, whether we failed to meet the 5/50 Rule, we will be treated as having met the 5/50 Rule.

Income Tests

We must satisfy two gross income requirements annually to maintain our qualification as a REIT:

We must derive, directly or indirectly, at least 75% of our gross income, excluding gross income from prohibited transactions, from specified real estate sources, including rental income, interest on obligations secured by mortgages on real property or on interests in real property, gain from the disposition of qualified real estate assets, i.e., interests in real property, mortgages secured by real property or interests in real property, and some other assets, income from certain types of temporary investments, amounts, such as commitment fees, received in consideration for entering into an

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agreement to make a loan secured by real property, unless such amounts are determined by income and profits, and income derived from a REMIC in proportion to the real estate assets held by the REMIC, unless at least 95% of the REMIC's assets are real estate assets (in which case, all of the income derived from the REMIC), or the 75% gross income test; and

We must derive at least 95% of our gross income, excluding gross income from prohibited transactions, from (a) the sources of income that satisfy the 75% gross income test, (b) dividends, interest and gain from the sale or disposition of stock or securities, or (c) any combination of the foregoing, or the 95% gross income test.

Gross income from servicing loans for third parties and loan origination fees is not qualifying income for purposes of either gross income test. Gross income from our sale of property that we hold primarily for sale to customers in the ordinary course of business is excluded from both the numerator and the denominator in both income tests. Income and gain from certain transactions that we enter into to hedge indebtedness incurred or to be incurred to acquire or carry real estate assets and that are clearly and timely identified as such are excluded from both the numerator and denominator for purposes of the 95% gross income test (but not the 75% gross income test).

For purposes of the 75% and 95% gross income tests, a REIT is deemed to have earned a proportionate share of the income earned by any partnership, or any limited liability company treated as a partnership for federal income tax purposes, in which it owns an interest, which share is determined by reference to its capital interest in such entity, and is deemed to have earned the income earned by any qualified REIT subsidiary (in general, a 100%-owned corporate subsidiary of a REIT). Interest earned by a REIT ordinarily does not qualify as income meeting the 75% or 95% gross income tests if the determination of all or some of the amount of interest depends in any way on the income or profits of any person. Interest will not be disqualified from meeting such tests, however, solely by reason of being based on a fixed percentage or percentages of receipts or sales.

The following paragraphs discuss in more detail the specific application of the gross income tests to us.

Interest. The term *interest*, as defined for purposes of both gross income tests, generally excludes any amount that is based in whole or in part on the income or profits of any person. However, interest generally includes the following:

an amount that is based on a fixed percentage or percentages of receipts or sales; and

an amount that is based on the income or profits of a debtor as long as the debtor derives substantially all of its income from the real property securing the debt from leasing substantially all of its interest in the property and only to the extent that the amounts received by the debtor would be qualifying rents from real property if received directly by a REIT.

If a loan contains a provision that entitles a REIT to a percentage of the borrower's gain upon the sale of the real property securing the loan or a percentage of the appreciation in the property's value as of a specific date, income attributable to that loan provision will be treated as gain from the sale of the property securing the loan, which generally is qualifying income for purposes of both gross income tests.

Interest on debt secured by a mortgage on real property or on interests in real property, including, for this purpose, discount points, prepayment penalties, loan assumption fees and late payment charges that are not compensation for services, generally is qualifying income for purposes of the 75% gross income test. However, if the highest principal amount of a loan outstanding during a taxable year exceeds the fair market value of the real property securing the loan as of the date the REIT agreed to originate or acquire the loan, a portion of the interest income from such loan will not be qualifying income for purposes of the 75% gross income test but will be qualifying income for purposes of the 95% gross income test. The portion of the interest income that will not be qualifying income for purposes of the 75% gross income test will be equal to the portion of the principal amount of the loan that is not secured by real property—that is, the amount by which the loan exceeds the value of the real estate that is security for the loan.

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The interest, original issue discount and market discount income that we receive from our mortgage loans and MBS generally will be qualifying income for purposes of both gross income tests. However, as discussed above, if the fair market value of the real estate securing any of our loans is less than the principal amount of the loan, a portion of the income from that loan will be qualifying income for purposes of the 95% gross income test but not the 75% gross income test.

Fee Income. We may receive various fees in connection with originating mortgage loans. The fees will be qualifying income for purposes of both the 75% and 95% income tests if they are received in consideration for entering into an agreement to make a loan secured by real property and the fees are not determined based on the borrower's income or profits. Therefore, commitment fees will generally be qualifying income for purposes of the income tests. Other fees, such as fees received for servicing loans for third parties and origination fees, are not qualifying income for purposes of either income test.

Dividends. Our share of any dividends received from any corporation (including any of our taxable REIT subsidiaries, but excluding any REIT) in which we own an equity interest will qualify for purposes of the 95% gross income test but not for purposes of the 75% gross income test. Our share of any dividends received from any other REIT in which we own an equity interest will be qualifying income for purposes of both gross income tests.

Rents from Real Property. We do not intend to acquire any real property, but we may acquire real property or an interest therein in the future. To the extent that we acquire real property or an interest therein, rents we receive will qualify as rents from real property in satisfying the gross income requirements for a REIT described above only if the following conditions are met:

First, the amount of rent must not be based, in whole or in part, on the income or profits of any person. However, an amount received or accrued generally will not be excluded from rents from real property solely by reason of being based on fixed percentages of receipts or sales.

Second, rents we receive from a related party tenant will not qualify as rents from real property in satisfying the gross income tests unless the tenant is a taxable REIT subsidiary, at least 90% of the property is leased to unrelated tenants and the rent paid by the taxable REIT subsidiary is substantially comparable to the rent paid by the unrelated tenants for comparable space. A tenant is a related party tenant if the REIT, or an actual or constructive owner of 10% or more of the REIT, actually or constructively owns 10% or more of the tenant.

Third, if rent attributable to personal property leased in connection with a lease of real property is greater than 15% of the total rent received under the lease, then the portion of rent attributable to the personal property will not qualify as rents from real property.

Fourth, we generally must not operate or manage our real property or furnish or render services to our tenants, other than through an independent contractor who is adequately compensated and from whom we do not derive revenue. However, we may provide services directly to tenants if the services are usually or customarily rendered in connection with the rental of space for occupancy only and are not considered to be provided for the tenants' convenience. In addition, we may provide a minimal amount of non-customary services to the tenants of a property, other than through an independent contractor, as long as our income from the services does not exceed 1% of our income from the related property. Furthermore, we may own up to 100% of the stock of a taxable REIT subsidiary, which may provide customary and non-customary services to tenants without tainting its rental income from the related properties.

Hedging Transactions. From time to time, we may enter into hedging transactions with respect to one or more of our assets or liabilities. Our hedging activities may include entering into interest rate swaps, caps and floors, options to purchase these items and futures and forward contracts. Income and gain from hedging transactions will be excluded from gross income for purposes of the 95% gross income test (but not the 75%

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gross income test). A hedging transaction includes any transaction entered into in the normal course of our trade or business primarily to manage the risk of interest rate, price changes or currency fluctuations with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, to acquire or carry real estate assets. We will be required to clearly identify any such hedging transaction before the close of the day on which it was acquired, originated or entered into. To the extent that we hedge for other purposes, or to the extent that a portion of our mortgage loans is not secured by real estate assets (as described below under Asset Tests), or in other situations, the income from those transactions is not likely to be treated as qualifying income for purposes of the 95% gross income test. All of our hedging income and gain likely will be non-qualifying income for purposes of the 75% gross income test. We intend to structure any hedging transactions in a manner that does not jeopardize our status as a REIT.

Prohibited Transactions. A REIT will incur a 100% tax on the net income derived from any sale or other disposition of property other than foreclosure property that the REIT holds primarily for sale to customers in the ordinary course of a trade or business. We believe that none of our assets will be held primarily for sale to customers and that a sale of any of our assets will not be in the ordinary course of our business. Whether a REIT holds an asset primarily for sale to customers in the ordinary course of a trade or business depends, however, on the facts and circumstances in effect from time to time, including those related to a particular asset. Nevertheless, we will attempt to comply with the terms of safe-harbor provisions in the federal income tax laws prescribing when an asset sale will not be characterized as a prohibited transaction.

It is our current intention that our securitizations of our residential real estate loans through our qualified REIT subsidiaries will not be treated as sales for tax purposes. If we were to transfer residential real estate loans to a REMIC, this transfer would be treated as a sale for tax purposes and the sale may be subject to the prohibited transactions tax. As a result, we intend to securitize our residential real estate loans through our qualified REIT subsidiaries only in non-REMIC transactions.

Foreclosure Property. We will be subject to tax at the maximum corporate rate on any income from foreclosure property other than income that otherwise would be qualifying income for purposes of the 75% gross income test, less expenses directly connected with the production of that income. However, gross income from foreclosure property will qualify under the 75% and 95% gross income tests. Foreclosure property is any real property, including interests in real property, and any personal property incident to such real property:

that is acquired by a REIT as the result of the REIT having bid on such property at foreclosure, or having otherwise reduced such property to ownership or possession by agreement or process of law, after there was a default or default was imminent on a lease of such property or on indebtedness that such property secured;

for which the related loan or lease was acquired by the REIT at a time when the default was not imminent or anticipated; and

for which the REIT makes a proper election to treat the property as foreclosure property.

However, a REIT will not be considered to have foreclosed on a property where the REIT takes control of the property as a mortgagee-in-possession and cannot receive any profit or sustain any loss except as a creditor of the mortgagor. Property generally ceases to be foreclosure property at the end of the third taxable year following the taxable year in which the REIT acquired the property or longer if an extension is granted by the Secretary of the Treasury. This grace period terminates and foreclosure property ceases to be foreclosure property on the first day:

on which a lease is entered into for the property that, by its terms, will give rise to income that does not qualify for purposes of the 75% gross income test or any amount is received or accrued, directly or indirectly, pursuant to a lease entered into on or after such day that will give rise to income that does not qualify for purposes of the 75% gross income test;

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on which any construction takes place on the property, other than completion of a building or any other improvement, where more than 10% of the construction was completed before default became imminent; or

which is more than 90 days after the day on which the REIT acquired the property and the property is used in a trade or business which is conducted by the REIT other than through an independent contractor from whom the REIT itself does not derive or receive any income.

Failure to Satisfy Gross Income Tests. If we fail to satisfy one or both of the gross income tests for any taxable year, we nevertheless may qualify as a REIT for that year if we qualify for relief under certain provisions of the federal income tax laws. Those relief provisions will be available if:

our failure to meet those tests is due to reasonable cause and not to willful neglect, and

following such failure for any taxable year, a schedule of the sources of our income is filed in accordance with regulations prescribed by the Secretary of the Treasury.

We cannot predict, however, whether in all circumstances we would qualify for the relief provisions. In addition, as discussed above, even if the relief provisions apply, we would incur a 100% tax on the gross income attributable to the greater of (i) the amount by which we fail the 75% gross income test or (ii) the amount by which 95% of our gross income exceeds the amount of our income qualifying under the 95% gross income test, multiplied, in either case, by a fraction intended to reflect our profitability.

Asset Tests

To qualify as a REIT, we also must satisfy the following asset tests at the end of each quarter of each taxable year:

First, at least 75% of the value of our total assets must consist of:

cash or cash items, including certain receivables;

government securities;

interests in real property, including leaseholds and options to acquire real property and leaseholds;

interests in mortgage loans secured by real property;

stock in other REITs;

investments in stock or debt instruments during the one-year period following our receipt of new capital that we raise through equity offerings or public offerings of debt with at least a five-year term; and

regular or residual interests in a REMIC. However, if less than 95% of the assets of a REMIC consist of assets that are qualifying real estate-related assets under the federal income tax laws, determined as if we held such assets, we will be treated as holding directly our proportionate share of the assets of such REMIC.

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Second, not more than 25% of the value of our total assets may be represented by securities (other than those included in the preceding category).

Third, not more than 20% of the value of our total assets may be represented by securities of one or more taxable REIT subsidiaries.

Fourth, except with respect to a taxable REIT subsidiary and securities includible in the first category above, (a) not more than 5% of the value of our total assets may be represented by securities of any one issuer, (b) we may not hold securities possessing more than 10% of the total voting power of the outstanding securities of any one issuer and (c) we may not hold securities having a value of more than 10% of the total value of the outstanding securities of any one issuer.

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For purposes of the second and third asset tests, the term "securities" does not include stock in another REIT, equity or debt securities of a qualified REIT subsidiary or taxable REIT subsidiary, mortgage loans that constitute real estate assets, or equity interests in a partnership. For purposes of the 10% value test, the term "securities" does not include:

Straight debt securities, which is defined as a written unconditional promise to pay on demand or on a specified date a sum certain in money if (i) the debt is not convertible, directly or indirectly, into stock, and (ii) the interest rate and interest payment dates are not contingent on profits, the borrower's discretion, or similar factors. Straight debt securities do not include any securities issued by a partnership or a corporation in which we or any controlled taxable REIT subsidiary (i.e., a taxable REIT subsidiary in which we own directly or indirectly more than 50% of the voting power or value of the stock) hold non- straight debt securities that have aggregate value of more than 1% of the issuer's outstanding securities. However, straight debt securities include debt subject to the following contingencies:

a contingency relating to the time of payment of interest or principal, as long as either (i) there is no change to the effective yield of the debt obligation other than a change to the annual yield that does not exceed the greater of 0.25% or 5% of the annual yield, or (ii) neither the aggregate issue price nor the aggregate face amount of the issuer's debt obligations held by us exceeds \$1 million and no more than 12 months of unaccrued interest on the debt obligations can be required to be prepaid; and

a contingency relating to the time or amount of payment upon a default or prepayment of a debt obligation, as long as the contingency is consistent with customary commercial practice.

Any loan to an individual or an estate.

Any section 467 rental agreement other than an agreement with a related party tenant.

Any obligation to pay rents from real property.

Certain securities issued by governmental entities.

Any security issued by a REIT.

Any debt instrument of an entity treated as a partnership for federal income tax purposes to the extent of our interest as a partner in the partnership.

Any debt instrument of an entity treated as a partnership for federal income tax purposes not described in the preceding bullet points if at least 75% of the partnership's gross income, excluding income from prohibited transaction, is qualifying income for purposes of the 75% gross income test described above in "Income Tests."

The asset tests described above are based on our gross assets. For federal income tax purposes, we will be treated as owning both the loans we hold directly and the loans that we have securitized through non-REMIC debt securitizations. Although we will have a partially offsetting obligation with respect to the securities issued pursuant to the securitizations, these offsetting obligations will not reduce the gross assets we are considered to own for purposes of the asset tests.

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We believe that all or substantially all of the mortgage loans and MBS that we will own will be qualifying assets for purposes of the 75% asset test. For purposes of these rules, however, if the outstanding principal balance of a mortgage loan exceeds the fair market value of the real property securing the loan, a portion of such loan likely will not be a qualifying real estate asset under the federal income tax laws. Although the law on the matter is not entirely clear, it appears that the non-qualifying portion of that mortgage loan will be equal to the portion of the loan amount that exceeds the value of the associated real property that is security for that loan. To the extent that we own debt securities issued by other REITs or C corporations that are not secured by a mortgage on real property, those debt securities will not be qualifying assets for purposes of the 75% asset test. Instead, we would be subject to the second, third and fourth asset tests with respect to those debt securities.

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We will monitor the status of our assets for purposes of the various asset tests and will seek to manage our investment portfolio to comply at all times with such tests. There can be no assurance, however, that we will be successful in this effort. In this regard, to determine our compliance with these requirements, we will need to estimate the value of the real estate securing our mortgage loans at various times. Although we will seek to be prudent in making these estimates, there can be no assurances that the IRS might not disagree with these determinations and assert that a lower value is applicable. If we fail to satisfy the asset tests at the end of a calendar quarter, we will not lose our REIT status if:

we satisfied the asset tests at the end of the preceding calendar quarter; and

the discrepancy between the value of our assets and the asset test requirements arose from changes in the market values of our assets and was not wholly or partly caused by the acquisition of one or more non-qualifying assets.

If we did not satisfy the condition described in the second item, above, we still could avoid disqualification by eliminating any discrepancy within 30 days after the close of the calendar quarter in which it arose.

In the event that, at the end of any calendar quarter, we violate the second or third asset tests described above, we will not lose our REIT status if (i) the failure is de minimis (up to the lesser of 1% of our assets or \$10 million) and (ii) we dispose of assets or otherwise comply with the asset tests within six months after the last day of the quarter in which we identify such failure. In the event of a more than de minimis failure of any of the asset tests, as long as the failure was due to reasonable cause and not to willful neglect, we will not lose our REIT status if (i) we dispose of assets or otherwise comply with the asset tests within six months after the last day of the quarter in which we identify such failure and (ii) pay a tax equal to the greater of \$50 thousand or 35% of the net income from the non-qualifying assets during the period in which we failed to satisfy the asset tests.

We currently believe that the loans, securities and other assets that we expect to hold will satisfy the foregoing asset test requirements. However, no independent appraisals will be obtained to support our conclusions as to the value of our assets and securities, or in many cases, the real estate collateral for the mortgage loans that we hold. Moreover, the values of some assets may not be susceptible to a precise determination. As a result, there can be no assurance that the IRS will not contend that our ownership of securities and other assets violates one or more of the asset tests applicable to REITs.

Distribution Requirements

Each taxable year, we must distribute dividends, other than capital gain dividends and deemed distributions of retained capital gain, to our stockholders in an aggregate amount at least equal to:

the sum of:

90% of our REIT taxable income, computed without regard to the dividends paid deduction and our net capital gain or loss, and

90% of our after-tax net income, if any, from foreclosure property, minus

the sum of certain items of excess non-cash income.

We must pay such distributions in the taxable year to which they relate or in the following taxable year if we declare the distribution before we timely file our federal income tax return for the year and pay the distribution on or before the first regular dividend payment date after such declaration. In addition, dividends declared in October, November or December payable to stockholders of record in such month are deemed received by stockholders on December 31 and to have been paid on December 31 if actually paid in January of the following year. See below under Distributions Generally.

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We will pay the federal income tax on taxable income, including net capital gain, which we do not distribute to stockholders. Furthermore, if we fail to distribute during a calendar year, or by the end of January following the calendar year in the case of distributions with declaration and record dates falling in the last three months of the calendar year, at least the sum of:

85% of our REIT ordinary income for such year,

95% of our REIT capital gain income for such year, and

any undistributed taxable income from prior periods, we will incur a 4% nondeductible excise tax on the excess of such required distribution over the amounts we actually distribute. We may elect to retain and pay income tax on the net long-term capital gain we receive in a taxable year. See Taxation of Taxable United States Stockholders. If we so elect, we will be treated as having distributed any such retained amount for purposes of the 4% nondeductible excise tax described above. We intend to make timely distributions sufficient to satisfy the annual distribution requirements and to avoid corporate income tax and the 4% nondeductible excise tax.

It is possible that, from time to time, we may experience timing differences between the actual receipt of income and actual payment of deductible expenses and the inclusion of that income and deduction of such expenses in arriving at our REIT taxable income. Possible examples of those timing differences include the following:

Because we may deduct capital losses only to the extent of our capital gains, we may have taxable income that exceeds our economic income.

We will recognize taxable income in advance of the related cash flow if any of our mortgage loans or MBS are deemed to have original issue discount. We generally must accrue original issue discount based on a constant yield method that takes into account projected prepayments but that defers taking into account credit losses until they are actually incurred.

We may recognize taxable market discount income when we receive the proceeds from the disposition of, or principal payments on, loans that have a stated redemption price at maturity that is greater than our tax basis in those loans, although such proceeds often will be used to make non-deductible principal payments on related borrowings.

We may recognize taxable income without receiving a corresponding cash distribution if we foreclose on or make a significant modification to a loan to the extent that the fair market value of the underlying property or the principal amount of the modified loan, as applicable, exceeds our basis in the original loan.

We may recognize phantom taxable income from any residual interests in REMICs or retained ownership interests in mortgage loans subject to collateralized mortgage obligation debt.

Although several types of non-cash income are excluded in determining the annual distribution requirement, we will incur corporate income tax and the 4% nondeductible excise tax with respect to those non-cash income items if we do not distribute those items on a current basis. As a result of the foregoing, we may have less cash than is necessary to distribute all of our taxable income and thereby avoid corporate income tax and the excise tax imposed on certain undistributed income. In such a situation, we may need to borrow funds or issue additional common stock or preferred stock.

Under certain circumstances, we may be able to correct a failure to meet the distribution requirement for a year by paying deficiency dividends to our stockholders in a later year. We may include such deficiency dividends in our deduction for dividends paid for the earlier year. Although

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we may be able to avoid income tax on amounts distributed as deficiency dividends, we will be required to pay interest to the IRS based upon the amount of any deduction we take for deficiency dividends.

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Recordkeeping Requirements

We must maintain certain records in order to qualify as a REIT. In addition, to avoid a monetary penalty, we must request, on an annual basis, information from our stockholders designed to disclose the actual ownership of our outstanding stock. We intend to comply with these requirements.

Failure to Qualify

If we fail to satisfy one or more requirements for REIT qualification, other than the gross income tests and the asset tests, we could avoid disqualification if our failure is due to reasonable cause and not to willful neglect and we pay a penalty of \$50 thousand for each such failure. In addition, there are relief provisions for a failure of the gross income tests and asset tests as described in [Income Tests](#) and [Asset Tests](#).

If we fail to qualify as a REIT in any taxable year and no relief provision applies, we would be subject to federal income tax and any applicable alternative minimum tax on our taxable income at regular corporate rates. In calculating our taxable income in a year in which we fail to qualify as a REIT, we would not be able to deduct amounts paid out to stockholders. In fact, we would not be required to distribute any amounts to stockholders in that year. In such event, to the extent of our current and accumulated earnings and profits, all distributions to stockholders would be taxable as ordinary income. Subject to certain limitations of the federal income tax laws, corporate stockholders might be eligible for the dividends received deduction and domestic non-corporate stockholders may be eligible for the reduced federal income tax rate of 15% on qualified dividends. Unless we qualified for relief under specific statutory provisions, we also would be disqualified from taxation as a REIT for the four taxable years following the year during which we ceased to qualify as a REIT. We cannot predict whether, in all circumstances, we would qualify for such statutory relief.

Qualified REIT Subsidiaries

A qualified REIT subsidiary is any corporation in which we own 100% of such corporation's outstanding stock and for which no election has been made to classify it as a taxable REIT subsidiary. Belvedere Trust, BT Management Holding Corporation, Belvedere Trust Secured Assets Corporation and BellaVista Finance Corporation are currently treated as qualified REIT subsidiaries. As such, their assets, liabilities and income are generally treated as our assets, liabilities and income for purposes of each of the above REIT qualification tests.

Taxable REIT Subsidiaries

A taxable REIT subsidiary is any corporation in which we own stock (directly or indirectly) and which we and such corporation elect to classify as a taxable REIT subsidiary. A taxable REIT subsidiary is not subject to the REIT asset, income and distribution requirements, nor are its assets, liabilities or income treated as our assets, liabilities or income for purposes of each of the above REIT qualification tests. Effective January 1, 2004, we elected to treat BT Finance as a taxable REIT subsidiary. BT Finance's wholly-owned subsidiaries, BT Residential Funding Corporation and BellaVista Funding Corporation, are also taxable REIT subsidiaries. We generally intend to make a taxable REIT subsidiary election with respect to any other corporation in which we acquire securities constituting more than 10% by vote or value of such corporation and that is not a qualified REIT subsidiary. However, the aggregate value of all of our taxable REIT subsidiaries must be limited to 20% of the total value of our assets.

We will be subject to a 100% penalty tax on any rent, interest or other charges that we impose on any taxable REIT subsidiary in excess of an arm's length price for comparable services. We expect that any rents, interest or other charges imposed on any taxable REIT subsidiary will be at arm's length prices.

We generally expect to derive income from our taxable REIT subsidiaries by way of dividends. Such dividends are not real estate source income for purposes of the 75% income test, although they are included for

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purposes of the 95% test. Therefore, when aggregated with our non-real estate source income, such dividends must be limited to 25% of our gross income each year. We will monitor the value of our investment in, and the distributions from, our taxable REIT subsidiaries to ensure compliance with all applicable REIT income and asset tests.

Taxable REIT subsidiaries are generally subject to corporate level tax on their net income and will generally be able to distribute only net after-tax earnings to its stockholders, including us, as dividend distributions. Our dividends sourced from dividends received from taxable REIT subsidiaries can qualify for the 15% tax rate on qualified dividends.

Taxation of Taxable United States Stockholders

For purposes of the discussion in this Annual Report on Form 10-K, the term **United States stockholder** means a holder of our stock that is, for United States federal income tax purposes:

a citizen or resident of the United States;

a corporation (including an entity treated as a corporation for federal income tax purposes), partnership or other entity created or organized in or under the laws of the United States or of any state thereof or in the District of Columbia, unless Treasury regulations provide otherwise;

an estate the income of which is subject to United States federal income taxation regardless of its source; or

a trust (i) whose administration is subject to the primary supervision of a United States court and which has one or more United States persons who have the authority to control all substantial decisions of the trust or (ii) that has a valid election in place to be treated as a United States person.

Distributions Generally

Distributions out of our current or accumulated earnings and profits, other than capital gain dividends, will generally be taxable to United States stockholders as ordinary income. Provided that we continue to qualify as a REIT, dividends paid by us will not be eligible for the dividends received deduction generally available to United States stockholders that are corporations. To the extent that we make distributions in excess of current and accumulated earnings and profits, the distributions will be treated as a tax-free return of capital to each United States stockholder and will reduce the adjusted tax basis which each United States stockholder has in our stock by the amount of the distribution, but not below zero. Distributions in excess of a United States stockholder's adjusted tax basis in its stock will be taxable as capital gain and will be taxable as long-term capital gain if the stock has been held for more than one year. If we declare a dividend in October, November, or December of any calendar year which is payable to stockholders of record on a specified date in such a month and actually pay the dividend during January of the following calendar year, the dividend is deemed to be paid by us and received by the stockholder on December 31st of the previous year, but only to the extent we have any remaining undistributed earnings and profits (as computed under the Code) as of December 31st. Any portion of this distribution in excess of our previously undistributed earnings and profits as of December 31st should be treated as a distribution to our stockholders in the following calendar year for United States federal income tax purposes. Stockholders may not include in their own income tax returns any of our net operating losses or capital losses. Ordinary dividends to a United States stockholder generally will not qualify for the 15% tax rate for qualified dividend income. However, the 15% tax rate for qualified dividend income will apply to our ordinary REIT dividends (i) attributable to dividends received by us from non-REIT corporations such as a taxable REIT subsidiary, and (ii) any income on which we have paid a corporate income tax.

Capital Gain Distributions

Distributions designated by us as capital gain dividends will be taxable to United States stockholders as capital gain income. We can designate distributions as capital gain dividends to the extent of our net capital gain

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for the taxable year of the distribution. This capital gain income will generally be taxable to non-corporate United States stockholders at a 15% or 25% rate based on the characteristics of the asset we sold that produced the gain. United States stockholders that are corporations may be required to treat up to 20% of certain capital gain dividends as ordinary income.

Retention of Net Capital Gains

We may elect to retain, rather than distribute as a capital gain dividend, our net capital gains. If we were to make this election, we would pay tax on such retained capital gains. In such a case, our stockholders would generally:

include their proportionate share of our undistributed net capital gains in their taxable income;

receive a credit for their proportionate share of the tax paid by us in respect of such net capital gain; and

increase the adjusted basis of their stock by the difference between the amount of their share of our undistributed net capital gain and their share of the tax paid by us.

Passive Activity Losses, Investment Interest Limitations and Other Considerations of Holding Our Stock

Distributions we make and gains arising from the sale or exchange of our stock by a United States stockholder will not be treated as passive activity income. As a result, United States stockholders will not be able to apply any passive losses against income or gains relating to our stock. Distributions by us, to the extent they do not constitute a return of capital, generally will be treated as investment income for purposes of computing the investment interest limitation under the Code. Further, if we, or a portion of our assets, were to be treated as a taxable mortgage pool, any excess inclusion income that is allocated to you could not be offset by any losses or other deductions you may have.

Dispositions of Stock

A United States stockholder that sells or disposes of our stock will recognize gain or loss for federal income tax purposes in an amount equal to the difference between the amount of cash or the fair market value of any property the stockholder receives on the sale or other disposition and the stockholder's adjusted tax basis in the stock. This gain or loss will be capital gain or loss and will be long-term capital gain or loss if the stockholder has held the stock for more than one year. In general, any loss recognized by a United States stockholder upon the sale or other disposition of our stock that the stockholder has held for six months or less will be treated as long-term capital loss to the extent the stockholder received distributions from us which were required to be treated as long-term capital gains. All or a portion of any loss that a United States stockholder realizes upon a taxable disposition of our common stock may be disallowed if the stockholder purchases other stock within 30 days before or after the disposition.

Information Reporting and Backup Withholding

We report to our United States stockholders and the IRS the amount of dividends paid during each calendar year and the amount of any tax withheld. Under the backup withholding rules, a stockholder may be subject to backup withholding with respect to dividends paid and redemption proceeds unless the holder is a corporation or comes within other exempt categories and, when required, demonstrates this fact or provides a taxpayer identification number or social security number certifying as to no loss of exemption from backup withholding and otherwise complies with applicable requirements of the backup withholding rules. A United States stockholder that does not provide us with its correct taxpayer identification number or social security number may also be subject to penalties imposed by the IRS. A United States stockholder can meet this requirement by providing us with a correct, properly completed and executed copy of IRS Form W-9 or a substantially similar form. Backup withholding is not an additional tax. Any amount paid as backup withholding will be creditable against the stockholder's income tax liability, if any, and otherwise be refundable. In addition, we may be required to withhold a portion of capital gain distributions made to any stockholders who fail to certify their non-foreign status.

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Taxation of Tax-Exempt Stockholders

The IRS has ruled that amounts distributed as a dividend by a REIT will be treated as a dividend by the recipient and excluded from the calculation of unrelated business taxable income, or UBTI, when received by a tax-exempt entity. Based on that ruling, provided that a tax-exempt stockholder has not held our stock as debt financed property within the meaning of the Code, i.e., property, the acquisition, or holding of which is financed through a borrowing by the tax-exempt United States stockholder, the stock is not otherwise used in an unrelated trade or business, and we do not hold a residual interest in a REMIC that gives rise to excess inclusion income, as defined in Section 860E of the Code, dividend income on our stock and income from the sale of our stock should not be unrelated business taxable income to a tax-exempt stockholder. However, if we or a pool of our assets were to be treated as a taxable mortgage pool, a portion of the dividends paid to a tax-exempt stockholder may be subject to tax as unrelated business taxable income. Although we do not believe that we, or any portion of our assets, will be treated as a taxable mortgage pool, no assurance can be given that the IRS might not successfully maintain that such a taxable mortgage pool exists.

For tax-exempt stockholders that are social clubs, voluntary employee benefit associations, supplemental unemployment benefit trusts, and qualified group legal services plans exempt from federal income taxation under Sections 501(c)(7), (c)(9), (c)(17) and (c)(20) of the Code, respectively, income from an investment in our stock will constitute unrelated business taxable income unless the organization is able to properly claim a deduction for amounts set aside or placed in reserve for certain purposes so as to offset the income generated by its investment in our stock. Any prospective and current investors should consult their tax advisors concerning these set aside and reserve requirements.

Notwithstanding the above, however, a substantial portion of the dividends a tax-exempt stockholder receives may constitute UBTI if we are treated as a pension-held REIT and the stockholder is a pension trust which:

is described in Section 401(a) of the Code; and

holds more than 10%, by value, of the interests in the REIT.

Tax-exempt pension funds that are described in Section 401(a) of the Code and exempt from tax under Section 501(a) of the Code are referred to below as qualified trusts.

A REIT is a pension-held REIT if:

it would not have qualified as a REIT but for the fact that Section 856(h)(3) of the Code provides that stock owned by a qualified trust shall be treated, for purposes of the 5/50 Rule, described above, as owned by the beneficiaries of the trust, rather than by the trust itself; and

either at least one qualified trust holds more than 25%, by value, of the interests in the REIT, or one or more qualified trusts, each of which owns more than 10%, by value, of the interests in the REIT, holds in the aggregate more than 50%, by value, of the interests in the REIT.

The percentage of any REIT dividend treated as unrelated business taxable income is equal to the ratio of:

the unrelated business taxable income earned by the REIT, less directly related expenses, treating the REIT as if it were a qualified trust and therefore subject to tax on unrelated business taxable income, to

the total gross income, less directly related expenses, of the REIT.

A de minimis exception applies where the percentage is less than 5% for any year. As a result of the limitations on the transfer and ownership of stock contained in our charter, we do not expect to be classified as a pension-held REIT.

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Taxation of Non-United States Stockholders

The rules governing federal income taxation of non-United States stockholders are complex and no attempt will be made herein to provide more than a summary of these rules. Non-United States stockholders means beneficial owners of shares of our stock that are not United States stockholders (as such term is defined in the discussion above under the heading entitled "Taxation of Taxable United States Stockholders").

PROSPECTIVE AND CURRENT NON-UNITED STATES STOCKHOLDERS SHOULD CONSULT THEIR TAX ADVISORS TO DETERMINE THE IMPACT OF FOREIGN, FEDERAL, STATE AND LOCAL INCOME TAX LAWS WITH REGARD TO AN INVESTMENT IN OUR STOCK AND OF OUR ELECTION TO BE TAXED AS A REAL ESTATE INVESTMENT TRUST, INCLUDING ANY REPORTING REQUIREMENTS.

Distributions to non-United States stockholders that are not attributable to gain from our sale or exchange of United States real property interests, and that are not designated by us as capital gain dividends or retained capital gains, will be treated as dividends of ordinary income to the extent that they are made out of our current or accumulated earnings and profits. These distributions will generally be subject to a withholding tax equal to 30% of the distribution unless an applicable tax treaty reduces or eliminates that tax. However, if income from an investment in our stock is treated as effectively connected with the non-United States stockholder's conduct of a United States trade or business, the non-United States stockholder generally will be subject to federal income tax at graduated rates on a net basis in the same manner as United States stockholders are taxed with respect to those distributions and also may be subject to the 30% branch profits tax in the case of a non-United States stockholder that is a corporation. We expect to withhold tax at the rate of 30% on the gross amount of any distributions made to a non-United States stockholder unless:

a lower treaty rate applies and any required form, for example IRS Form W-8BEN, evidencing eligibility for that reduced rate is filed by the non-United States stockholder with us; or

the non-United States stockholder files an IRS Form W-8ECI with us claiming that the distribution is effectively connected income. Any portion of the dividends paid to non-United States stockholders that is treated as excess inclusion income will not be eligible for exemption from the 30% withholding tax or a reduced treaty rate.

Distributions in excess of our current and accumulated earnings and profits will not be taxable to non-United States stockholders to the extent that these distributions do not exceed the adjusted basis of the stockholder's stock, but rather will reduce the adjusted basis of that stock. To the extent that distributions in excess of current and accumulated earnings and profits exceed the adjusted basis of a non-United States stockholder's stock, these distributions will give rise to tax liability if the non-United States stockholder would otherwise be subject to tax on any gain from the sale or disposition of its stock, as described below. Because it generally cannot be determined at the time a distribution is made whether or not such distribution may be in excess of current and accumulated earnings and profits, the entire amount of any distribution normally will be subject to withholding at the same rate as a dividend. However, amounts so withheld are creditable against United States tax liability, if any, or refundable by the IRS to the extent the distribution is subsequently determined to be in excess of our current and accumulated earnings and profits. We are also required to withhold 10% of any distribution in excess of our current and accumulated earnings and profits if our stock is a United States real property interest because we are not a domestically controlled REIT, as discussed below. Consequently, although we intend to withhold at a rate of 30% on the entire amount of any distribution, to the extent that we do not do so, any portion of a distribution not subject to withholding at a rate of 30% may be subject to withholding at a rate of 10%.

Distributions attributable to our capital gains which are not attributable to gain from the sale or exchange of a United States real property interest generally will not be subject to income taxation unless (1) investment in our stock is effectively connected with the non-United States stockholder's U.S. trade or business (or, if an income

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tax treaty applies, is attributable to a U.S. permanent establishment of the non-United States stockholder), in which case the non-United States stockholder will be subject to the same treatment as United States stockholders with respect to such gain (except that a corporate non-United States stockholder may also be subject to the 30% branch profits tax), or (2) the non-United States stockholder is a non-resident alien individual who is present in the United States for 183 days or more during the taxable year and certain other conditions are satisfied, in which case the non-resident alien individual will be subject to a 30% tax on the individual's capital gains.

For any year in which we qualify as a REIT, distributions that are attributable to gain from the sale or exchange of a United States real property interest, which includes some interests in real property, but generally does not include an interest solely as a creditor in mortgage loans or MBS, will be taxed to a non-United States stockholder under the provisions of the Foreign Investment in Real Property Tax Act of 1980, or FIRPTA. Under FIRPTA, distributions attributable to gain from sales of United States real property interests are taxed to a non-United States stockholder as if that gain were effectively connected with the stockholder's conduct of a United States trade or business. Non-United States stockholders thus would be taxed at the normal capital gain rates applicable to stockholders, subject to applicable alternative minimum tax and a special alternative minimum tax in the case of nonresident alien individuals. Distributions subject to FIRPTA also may be subject to the 30% branch profits tax in the hands of a non-United States corporate stockholder. We are required to withhold 35% of any distribution that we designate (or, if greater, the amount that we could designate) as a capital gains dividend. The amount withheld is creditable against the non-United States stockholder's FIRPTA tax liability.

A capital gain distribution from a REIT to a foreign investor has been removed from the category of effectively connected income, provided that (i) the distribution is received with respect to a class of stock that is regularly traded on an established securities market located in the United States (our stock currently is so traded) and (ii) the foreign investor does not own more than 5% of the class of stock at any time during the taxable year within which the distribution is received. In that case, the foreign investor is not required to file a U.S. federal income tax return by reason of receiving such a distribution. The distribution is to be treated as a REIT dividend to that investor, taxed as a REIT dividend that is not a capital gain. Also, the branch profits tax does not apply to such a distribution.

Gains recognized by a non-United States stockholder upon a sale of our stock generally will not be taxed under FIRPTA if we are a domestically-controlled REIT, which is a REIT in which at all times during a specified testing period less than 50% in value of the stock was held directly or indirectly by non-United States stockholders. Because our stock is publicly traded, we cannot assure our investors that we are or will remain a domestically-controlled REIT. Even if we are not a domestically-controlled REIT, however, a non-United States stockholder that owns, actually or constructively, 5% or less of our stock throughout a specified testing period will not recognize taxable gain on the sale of our stock under FIRPTA if the shares are traded on an established securities market.

If gain from the sale of the stock were subject to taxation under FIRPTA, the non-United States stockholder would be subject to the same treatment as United States stockholders with respect to that gain, subject to applicable alternative minimum tax, a special alternative minimum tax in the case of nonresident alien individuals, and the possible application of the 30% branch profits tax in the case of non-United States corporations. In addition, the purchaser of the stock could be required to withhold 10% of the purchase price and remit such amount to the IRS.

Gains not subject to FIRPTA will be taxable to a non-United States stockholder if:

the non-United States stockholder's investment in the stock is effectively connected with a trade or business in the United States, in which case the non-United States stockholder will be subject to the same treatment as United States stockholders with respect to that gain; or

the non-United States stockholder is a nonresident alien individual who was present in the United States for 183 days or more during the taxable year and other conditions are met, in which case the nonresident alien individual will be subject to a 30% tax on the individual's capital gains.

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Information Reporting and Backup Withholding

If the proceeds of a disposition of our stock are paid by or through a U.S. office of a broker-dealer, the payment is generally subject to information reporting and to backup withholding (currently at a rate of 28%) unless the disposing non-United States stockholder certifies as to his name, address and non-U.S. status or otherwise establishes an exemption. Generally, U.S. information reporting and backup withholding will not apply to a payment of disposition proceeds if the payment is made outside the U.S. through a foreign office of a foreign broker-dealer. If the proceeds from a disposition of our stock are paid to or through a foreign office of a U.S. broker-dealer or a non-U.S. office of a foreign broker-dealer that is (i) a controlled foreign corporation for federal income tax purposes, (ii) a foreign person 50% or more of whose gross income from all sources for a three-year period was effectively connected with a U.S. trade or business, (iii) a foreign partnership with one or more partners who are U.S. persons and who in the aggregate hold more than 50% of the income or capital interest in the partnership, or (iv) a foreign partnership engaged in the conduct of a trade or business in the United States, then (i) backup withholding will not apply unless the broker-dealer has actual knowledge that the owner is not a foreign stockholder, and (ii) information reporting will not apply if the non-United States stockholder satisfies certification requirements regarding its status as a foreign stockholder.

State, Local and Foreign Taxation

We may be required to pay state, local and foreign taxes in various state, local and foreign jurisdictions, including those in which we transact business or make investments, and our stockholders may be required to pay state, local and foreign taxes in various state, local and foreign jurisdictions, including those in which they reside. Our state, local and foreign tax treatment may not conform to the federal income tax consequences summarized above. In addition, a stockholder's state, local and foreign tax treatment may not conform to the federal income tax consequences summarized above. Consequently, prospective investors should consult their tax advisors regarding the effect of state, local and foreign tax laws on an investment in our stock.

Possible Legislative or Other Actions Affecting Tax Considerations

Prospective investors and stockholders should recognize that the present U.S. federal income tax treatment of an investment in our stock may be modified by legislative, judicial or administrative action at any time and that any such action may affect investments and commitments previously made. The rules dealing with U.S. federal income taxation are constantly under review by persons involved in the legislative process and by the IRS and the U.S. Treasury Department, resulting in revisions of regulations and revised interpretations of established concepts as well as statutory changes. Revisions in U.S. federal tax laws and interpretations thereof could adversely affect the tax consequences of an investment in our stock.

Item 1A. RISK FACTORS

Our business routinely encounters and addresses risks, some of which will cause our future results to differ, sometimes materially, from those originally anticipated. Below, we have described our present view of certain important strategic risks. The risk factors set forth below are not the only risks that we may face or that could adversely affect us. If any of the risks discussed in this Annual Report on Form 10-K actually occur, our business, financial condition and results of operations could be materially adversely affected. If this were to occur, the trading price of our securities could decline significantly and you may lose all or part of your investment.

The following discussion of risk factors contains forward-looking statements, which may be important to understanding any statement in this Annual Report on Form 10-K or elsewhere. The following information should be read in conjunction with Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) and Item 8 Financial Statements and Supplementary Data of this Annual Report on Form 10-K.

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Risks Related to Our Business

Our leveraging strategy increases the risks of our operations.

Relative to our investment grade Agency MBS and Non-Agency MBS, we generally borrow, on a short-term basis, between eight to twelve times the amount of our equity, although our borrowings may at times be above or below this amount. We incur this leverage by borrowing against a substantial portion of the market value of our mortgage-related assets. Use of leverage can enhance our investment returns. Leverage, however, also increases risks. In the following ways, the use of leverage increases our risk of loss and may reduce our net income by increasing the risks associated with other risk factors including a decline in the market value of our MBS or a default of a mortgage-related asset:

The use of leverage increases our risk of loss resulting from various factors including rising interest rates, increased interest rate volatility, downturns in the economy and reductions in the availability of financing or deterioration in the conditions of any of our mortgage-related assets.

A majority of our borrowings are secured by our mortgage-related assets, generally under repurchase agreements. A decline in the market value of the mortgage-related assets used to secure these debt obligations could limit our ability to borrow or result in lenders requiring us to pledge additional collateral to secure our borrowings. In that situation, we could be required to sell mortgage-related assets under adverse market conditions in order to obtain the additional collateral required by the lender. If these sales are made at prices lower than the carrying value of the MBS, we would experience losses.

A default of a mortgage-related asset that constitutes collateral for a repurchase agreement could also result in an involuntary liquidation of the mortgage-related asset. This would result in a loss to us of the difference between the value of the mortgage-related asset upon liquidation and the amount borrowed against the mortgage-related asset.

To the extent we are compelled to liquidate qualified REIT assets to repay debts, our compliance with the REIT rules regarding our assets and our sources of income could be affected, which could jeopardize our status as a REIT. Losing our REIT status would cause us to lose tax advantages applicable to REITs and may decrease our overall profitability and distributions to our stockholders.

We may incur increased borrowing costs related to repurchase agreements and that would adversely affect our profitability.

Currently, all of our borrowings are collateralized borrowings in the form of repurchase agreements. If the interest rates on these agreements increase, that would harm our profitability.

Our borrowing costs under repurchase agreements generally correspond to short-term interest rates such as LIBOR or a short-term Treasury index, plus or minus a margin. The margins on these borrowings over or under short-term interest rates may vary depending upon:

the movement of interest rates;

the availability of financing in the market; and

the value and liquidity of our mortgage-related assets.

An increase in interest rates may harm our book value, which could adversely affect the cash available for distribution to you and could cause the price of our securities to decline.

Increases in interest rates may harm the market value of our mortgage-related assets. Our hybrid adjustable-rate mortgage-related assets (during the fixed-rate component of the mortgages underlying such assets) and our fixed-rate securities are generally more harmed by these increases. In

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accordance with GAAP, we reduce our book value by the amount of any decrease in the market value of our mortgage-related assets. Losses on

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securities classified as available-for-sale, which are determined by management to be other-than-temporary in nature, are reclassified from Accumulated other comprehensive income to current operations.

An increase in interest rates may cause a decrease in the volume of newly issued, or investor demand for, MBS and other mortgage-related assets, which could adversely affect our ability to acquire MBS and other mortgage-related assets that satisfy our investment objectives and to generate income and pay dividends.

Rising interest rates generally reduce the demand for consumer credit, including mortgage loans, due to the higher cost of borrowing. A reduction in the volume of mortgage loans originated may affect the volume of MBS and other mortgage-related assets available to us, which could affect our ability to acquire MBS and other mortgage-related assets that satisfy our investment objectives. Rising interest rates may also cause MBS and other mortgage-related assets that were issued prior to an interest rate increase to provide yields that exceed prevailing market interest rates. If rising interest rates cause us to be unable to acquire a sufficient volume of MBS or mortgage-related assets or MBS or mortgage-related assets with a yield that exceeds the borrowing cost we will incur to purchase MBS or mortgage-related assets, our ability to satisfy our investment objectives and to generate income and pay dividends in the amount expected, or at all, may be materially and adversely affected.

A flat or inverted yield curve may negatively affect our operations, book value and profitability due to its potential impact on investment yields and the supply of adjustable-rate mortgage, or ARM, products.

A flat yield curve occurs when there is little difference between short-term and long-term interest rates. An inverted yield curve occurs when short-term interest rates are higher than long-term interest rates. A flat or inverted yield curve may be an adverse environment for ARM product volume, as there may be little incentive for borrowers to choose an ARM product over a longer-term fixed-rate loan. If the supply of ARM product decreases, yields may decline due to market forces.

Our borrowing costs under repurchase agreements generally correspond to short-term interest rates such as LIBOR. A flat or inverted yield curve will likely result in lower profits.

Additionally, a flat or inverted yield curve may negatively impact the pricing of our securities. According to GAAP, if the values of our securities decrease, we reduce our book value by the amount of any decrease in the market value of our mortgage-related assets.

We depend on short-term borrowings to purchase mortgage-related assets and reach our desired amount of leverage. If we fail to obtain or renew sufficient funding on favorable terms, we will be limited in our ability to acquire mortgage-related assets and our earnings and profitability would decline.

We depend on short-term borrowings to fund acquisitions of mortgage-related assets and reach our desired amount of leverage. Accordingly, our ability to achieve our investment and leverage objectives depends on our ability to borrow money in sufficient amounts and on favorable terms. In addition, we must be able to renew or replace our maturing short-term borrowings on a continuous basis. Moreover, we depend on a limited number of lenders to provide the primary credit facilities for our purchases of mortgage-related assets.

If we cannot renew or replace maturing borrowings, we may have to sell our mortgage-related assets under adverse market conditions and may incur permanent capital losses as a result. Any number of these factors in combination may cause difficulties for us, including a possible liquidation of a major portion of our portfolio at disadvantageous prices with consequent losses, which may render us insolvent.

Our failure to procure funding on favorable terms, or at all, would adversely affect our results and may, in turn, negatively affect the market price of shares of our common stock.

The current situation in the sub-prime mortgage sector, and the current weakness in the broader mortgage market, could adversely affect one of more of our lenders and could cause one or more of our lenders to be

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unwilling or unable to provide us with additional financing. This could potentially increase our financing costs and reduce liquidity. If one or more major market participants fails, it could negatively impact the marketability of all fixed income securities, including agency mortgage-backed securities, and this could negatively impact the value of the securities in our portfolio, thus reducing our net book value. Furthermore, if many of our lenders are unwilling or unable to provide us with additional financing, we could be forced to sell our assets at an inopportune time when prices are depressed.

If we are unable to negotiate favorable terms and conditions on future repurchase agreements with one or more of our lenders, our financial condition and earnings could be negatively impacted.

The terms and conditions of each repurchase agreement with our lenders are negotiated on a transaction-by-transaction basis. Key terms and conditions of each transaction include interest rates, maturity dates, asset pricing procedures and margin requirements. We cannot assure you that we will be able to continue to negotiate favorable terms and conditions on our future repurchase agreements. Also, during periods of market illiquidity or due to perceived credit quality deterioration of the collateral pledged, a lender may require that less favorable asset pricing procedures be employed or the margin requirement be increased. Under these conditions, we may determine it is prudent to sell assets to improve our ability to pledge sufficient collateral to support our remaining borrowings. Such sales may be at disadvantageous times, which may harm our operating results and net profitability.

Possible market developments could cause our lenders to require us to pledge additional assets as collateral. If our assets are insufficient to meet the collateral requirements, then we may be compelled to liquidate particular assets at an inopportune time.

Possible market developments, including a sharp rise in interest rates, a change in prepayment rates or increasing market concern about the value or liquidity of one or more types of mortgage-related assets in which our portfolio is concentrated may reduce the market value of our portfolio, which may cause our lenders to require additional collateral. This requirement for additional collateral may compel us to liquidate our assets at a disadvantageous time, thus harming our operating results and net profitability.

Our use of repurchase agreements to borrow funds may give our lenders greater rights in the event that either we or a lender files for bankruptcy.

Our borrowings under repurchase agreements may qualify for special treatment under the bankruptcy code, giving our lenders the ability to avoid the automatic stay provisions of the bankruptcy code and to take possession of and liquidate our collateral under the repurchase agreements without delay in the event that we file for bankruptcy. Furthermore, the special treatment of repurchase agreements under the bankruptcy code may make it difficult for us to recover our pledged assets in the event that a lender files for bankruptcy. Thus, the use of repurchase agreements exposes our pledged assets to risk in the event of a bankruptcy filing by either a lender or us.

Because assets we acquire may experience periods of illiquidity, we may lose profits or be prevented from earning capital gains if we cannot sell mortgage-related assets at an opportune time.

We bear the risk of being unable to dispose of our mortgage-related assets at advantageous times or in a timely manner because mortgage-related assets generally experience periods of illiquidity. The lack of liquidity may result from the absence of a willing buyer or an established market for these assets, as well as legal or contractual restrictions on resale. As a result, the illiquidity of mortgage-related assets may cause us to lose profits and the ability to earn capital gains.

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Our hedging strategies may not be successful in mitigating our risks associated with interest rates.

We engage in hedging activity from time to time. As such, we use various derivative financial instruments to provide a level of protection against interest rate risks, but no hedging strategy can protect us completely. When interest rates change, we expect to record a gain or loss on derivatives, which would be offset by an inverse change in the value of loans or residual interests. Additionally, from time to time, we may enter into hedging transactions in connection with our holdings of MBS and government securities with respect to one or more of our assets or liabilities. Our hedging activities may include entering into interest rate swaps, caps and floors, options to purchase these items and futures and forward contracts. Our actual hedging decisions will be determined in light of the facts and circumstances existing at the time and may differ from our currently anticipated hedging strategy. We cannot assure you that our use of derivatives will offset the risks related to changes in interest rates. It is likely that there will be periods in the future during which we will incur losses after accounting for our derivative financial instruments. The derivative financial instruments we select may not have the effect of reducing our interest rate risk. In addition, the nature and timing of hedging transactions may influence the effectiveness of these strategies. Poorly designed strategies or improperly executed transactions could actually increase our risk and losses. In addition, hedging strategies involve transaction and other costs. We cannot assure you that our hedging strategy and the derivatives that we use will adequately offset the risk of interest rate volatility or that our hedging transactions will not result in losses.

Our use of derivatives may expose us to counterparty risks.

From time to time we enter into interest rate swap and cap agreements to hedge risks associated with movements in interest rates. If a swap counterparty cannot perform under the terms of an interest rate swap, we would not receive payments due under that agreement, we may lose any unrealized gain associated with the interest rate swap, and the hedged liability would cease to be hedged by the interest rate swap. We may also be at risk for any collateral we have pledged to secure our obligations under the interest rate swap if the counterparty becomes insolvent or files for bankruptcy. Similarly, if a cap counterparty fails to perform under the terms of the cap agreement, in addition to not receiving payments due under that agreement that would off-set our interest expense, we would also incur a loss for all remaining unamortized premium paid for that agreement.

Competition may prevent us from acquiring mortgage-related assets at favorable yields and that would negatively impact our profitability.

Our net income largely depends on our ability to acquire mortgage-related assets at favorable spreads over our borrowing costs. In acquiring mortgage-related assets, we compete with other REITs, investment banking firms, savings and loan associations, banks, insurance companies, mutual funds, other lenders and other entities that purchase mortgage-related assets, many of which have greater financial resources than us. As a result, we may not in the future be able to acquire sufficient mortgage-related assets at favorable spreads over our borrowing costs. If that occurs, our profitability will be harmed.

Interest rate mismatches between our adjustable-rate MBS and our borrowings used to fund our purchases of these assets may reduce our income during periods of changing interest rates.

We fund most of our acquisitions of adjustable-rate MBS with borrowings that have interest rates based on indices and repricing terms similar to, but of shorter maturities than, the interest rate indices and repricing terms of our MBS. Accordingly, if short-term interest rates increase, this may harm our profitability.

Most of the MBS we acquire are adjustable-rate securities. This means that their interest rates may vary over time based upon changes in a short-term interest rate index. Therefore, in most cases, the interest rate indices and repricing terms of the MBS that we acquire and their funding sources will not be identical, thereby creating an interest rate mismatch between our assets and liabilities. While the historical spread between relevant short-term interest rate indices has been relatively stable, there have been periods when the spread between these indices was volatile. During periods of changing interest rates, these mismatches could reduce our net income, dividend yield and the market price of our stock.

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The interest rates on our borrowings generally adjust more frequently than the interest rates on our adjustable-rate MBS. For example, at December 31, 2007, our Agency MBS and Non-Agency adjustable-rate MBS had a weighted average term to next rate adjustment of approximately 36 months, while our borrowings had a weighted average term to next rate adjustment of 49 days. After adjusting for interest rate swap transactions, the weighted average term to next rate adjustment was 418 days. Accordingly, in a period of rising interest rates, we could experience a decrease in net income or a net loss because the interest rates on our borrowings adjust faster than the interest rates on our adjustable-rate MBS.

The mortgage related assets in which we invest and the mortgage loans underlying the MBS and asset-backed securities in which we invest are subject to delinquency, foreclosure and loss, which could result in losses to us.

Residential mortgage loans are secured by single-family residential property and are subject to risks of loss, delinquency and foreclosure. The ability of a borrower to repay a loan secured by a residential property is dependent upon the income or assets of the borrower. A number of factors, including a general economic downturn, acts of God, terrorism, social unrest and civil disturbances, may impair borrowers' abilities to repay their loans.

Residential MBS evidence interests in or are secured by pools of residential mortgage loans and collateralized MBS evidence interests in or are secured by a single commercial mortgage loan or a pool of commercial mortgage loans. Accordingly, the MBS we invest in are subject to all of the risks of the underlying mortgage loans. In the event of defaults with respect to the mortgage loans that underlie our MBS investments and the exhaustion of any underlying or additional credit support, we may not realize our anticipated return on these investments and we may incur a loss on these investments.

Asset-backed securities are bonds or notes backed by loans and/or other financial assets. The ability of a borrower to repay these loans or other financial assets is dependant upon the income or assets of these borrowers.

Increased levels of prepayments from MBS may decrease our net interest income.

Pools of mortgage loans underlie the MBS that we acquire. We generally receive payments from principal payments that are made on these underlying mortgage loans. When borrowers prepay their mortgage loans faster than expected, this results in prepayments that are faster than expected on the MBS. Faster than expected prepayments could harm our profitability as follows:

We usually purchase MBS that have a higher interest rate than the market interest rate at the time. In exchange for this higher interest rate, we pay a premium over the par value to acquire the security. In accordance with accounting rules, we amortize this premium over the term of the mortgage-backed security. If the mortgage-backed security is prepaid in whole or in part prior to its maturity date, however, we expense the premium that was prepaid at the time of the prepayment. At December 31, 2007, substantially all of our MBS had been acquired at a premium.

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

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

Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by conditions in the housing and financial markets, general economic conditions and the relative interest rates on fixed-rate and adjustable-rate mortgage loans.

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While we seek to minimize prepayment risk to the extent practical, in selecting investments, we must balance prepayment risk against other risks and the potential returns of each investment. No strategy can completely insulate us from prepayment risk.

We may experience reduced net interest income from holding fixed-rate investments during periods of rising interest rates.

We generally fund our acquisition of fixed-rate MBS with short-term borrowings. During periods of rising interest rates, our costs associated with borrowings used to fund acquisition of fixed-rate assets are subject to increases while the income we earn from these assets remains substantially fixed. This reduces or could eliminate the net interest spread between the fixed-rate MBS that we purchase and our borrowings used to purchase them, which could lower our net interest income or cause us to suffer a loss. At December 31, 2007, 18% of our Agency MBS were fixed-rate securities.

Interest rate caps on our adjustable-rate MBS may reduce our income or cause us to suffer a loss during periods of rising interest rates.

Our adjustable-rate MBS are subject to periodic and lifetime interest rate caps. Periodic interest rate caps limit the amount an interest rate can increase during any given period. Lifetime interest rate caps limit the amount an interest rate can increase through maturity of a mortgage-backed security. Our borrowings are not subject to similar restrictions. Accordingly, in a period of rapidly increasing interest rates, the interest rates paid on our borrowings could increase without limitation while interest rate caps would limit the interest rates on our adjustable-rate MBS. This problem is magnified for our adjustable-rate MBS that are not fully indexed. Further, some adjustable-rate MBS may be subject to periodic payment caps that result in a portion of the interest being deferred and added to the principal outstanding. As a result, we could receive less cash income on adjustable-rate MBS than we need to pay interest on our related borrowings. These factors could lower our net interest income or cause us to suffer a loss during periods of rising interest rates. At December 31, 2007, approximately 82% of our Agency MBS were adjustable-rate securities.

We may invest in leveraged mortgage derivative securities that generally experience greater volatility in market prices, thus exposing us to greater risk with respect to their rate of return.

We may acquire leveraged mortgage derivative securities that may expose us to a high level of interest rate risk. The characteristics of leveraged mortgage derivative securities result in greater volatility in their market prices. Thus, acquisition of leveraged mortgage derivative securities would expose us to the risk of greater price volatility in our portfolio and that could harm our net income and overall profitability.

New assets we acquire may not generate yields as attractive or be as accretive to book value as have been experienced historically.

We may acquire new assets as we receive principal and interest payments and prepayments from our existing assets. We also sell assets from time to time as part of our portfolio and asset/liability management programs. We may invest these proceeds into new earning assets.

New assets may not generate yields as attractive as we have experienced historically. Business conditions, including credit results, prepayment patterns and interest rate trends in the future, may not be as favorable as they have been during the periods we held the replaced assets.

New assets may not be as accretive to book value as existing assets. The market value of our assets is sensitive to interest rate fluctuations. In the past as short-term interest rates increased, the market value of our existing assets has declined. As we classify our Agency MBS and Non-Agency MBS as available-for-sale, accounting regulations require that any unrealized losses from the decline in market value be carried as

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Accumulated other comprehensive loss in the Stockholders' equity section of the Consolidated Balance Sheets. When short-term interest rates stop increasing, or start declining, or when the interest rates on these securities reset, the market value of these assets will increase. This may be more accretive to book value than the new assets that we acquire to replace existing assets.

Our investment policy involves risks associated with the credit quality of our investments. If the credit quality of our investments declines or if there are defaults on the investments we make, our profitability may decline and we may suffer losses.

Our MBS have primarily been agency certificates that, although not rated, carry an implied AAA rating. Agency certificates are MBS where either Freddie Mac or Fannie Mae guarantees payments of principal or interest on the certificates. Freddie Mac and Fannie Mae are government-sponsored enterprises, or GSEs, and securities guaranteed by these GSEs are not guaranteed by the United States government. Our capital investment policy, however, provides us with the ability to acquire a material amount of lower credit quality MBS. If we acquire MBS of lower credit quality, our profitability may decline and we may incur losses if there are defaults on the mortgages backing those securities or if the rating agencies downgrade the credit quality of those securities or the securities of Fannie Mae and Freddie Mac.

Changes to the nature, extent or regulation of the business activities of Fannie Mae or Freddie Mac or declines in the U.S. real estate or credit markets might adversely affect their credit ratings and the market prices of their securities, including MBS to be acquired by us.

Fannie Mae and Freddie Mac are shareholder-owned publicly traded corporations created by charters of the U.S. Congress. They are commonly referred to as government-sponsored enterprises, or GSEs, because of their special relationship with the U.S. government, although their obligations are not guaranteed by the U.S. government. Fannie Mae and Freddie Mac purchase mortgage loans from mortgage originators and either hold those mortgages in their portfolios or pool them into MBS, which they guarantee for full and timely payment of principal and interest, regardless of whether the mortgagors actually make the payments. Fannie Mae's and Freddie Mac's obligations in respect of their respective guarantees rank equally with their respective senior unsecured debt securities, which are currently rated AAA by Standard & Poor's, Moody's and Fitch.

There can be no assurance that Fannie Mae or Freddie Mac will continue to maintain their special relationship with the U.S. government or that the current regulatory structure of Fannie Mae and Freddie Mac will be maintained. Furthermore, the recent conditions in the U.S. subprime mortgage market have exposed Fannie Mae and Freddie Mac to substantial losses, and they could face more losses if the U.S. real estate and credit markets continue to decline. Elimination or modification of the special relationship or a change in their current regulatory structure, or further declines in the U.S. real estate or credit markets, could require or cause Fannie Mae or Freddie Mac to change the nature and extent of their business activities (including the type or amount of MBS they issue), could adversely affect their activities, financial condition and overall risk profile, and could adversely affect their credit ratings and the market prices of the MBS created and guaranteed by them, and hence our shareholders' equity.

Risks Related to Our Management

Our officers devote a portion of their time to other companies in capacities that could create conflicts of interest that may harm our investment opportunities; this lack of a full-time commitment could also harm our operating results.

Lloyd McAdams, Joseph E. McAdams, Thad M. Brown, Bistra Pashamova and other of our officers and employees are officers and employees of Pacific Income Advisers, or PIA, where they devote a portion of their time. These officers and employees are under no contractual obligations mandating minimum amounts of time to be devoted to our company. In addition, a trust controlled by Lloyd McAdams is the principal stockholder of PIA.

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These officers and employees are involved in investing both our assets and approximately \$4 billion in MBS and other fixed income assets for institutional clients and individual investors through PIA. These multiple responsibilities and ownerships may create conflicts of interest if these officers and employees of our company are presented with opportunities that may benefit both us and the clients of PIA. These officers allocate investments among our portfolio and the clients of PIA by determining the entity or account for which the investment is most suitable. In making this determination, these officers consider the investment strategy and guidelines of each entity or account with respect to acquisition of assets, leverage, liquidity and other factors that our officers determine appropriate. These officers, however, have no obligation to make any specific investment opportunities available to us and the above-mentioned conflicts of interest may result in decisions or allocations of securities that are not in our best interests.

Lloyd McAdams is also an owner and Chairman of Syndicated Capital, Inc., a registered broker-dealer. Our officers' service to PIA and Syndicated Capital, Inc. allow them to spend only part of their time and effort managing our company, as they are required to devote a portion of their time and effort to the management of other companies, and this may harm our overall management and operating results.

Our board of directors may change our operating policies and strategies without prior notice or stockholder approval and such changes could harm our business, results of operation and stock price.

Our board of directors can modify or waive our current operating policies and our strategies without prior notice and without stockholder approval. We cannot predict the effect any changes to our current operating policies and strategies may have on our business, operating results and stock price, however, the effects may be adverse.

We depend on our key personnel and the loss of any of our key personnel could harm our operations.

We depend on the diligence, experience and skill of our officers and other employees for the selection, structuring and monitoring of our mortgage-related assets and associated borrowings. Our key officers include Lloyd McAdams, Chairman, President and Chief Executive Officer (Principal Executive Officer); Joseph E. McAdams, Chief Investment Officer, Executive Vice President and Director; Thad M. Brown, Chief Financial Officer (Principal Financial Officer), Treasurer and Secretary; Charles J. Siegel, Senior Vice President-Finance and Assistant Secretary; Evangelos Karagiannis, Vice President; and Bistra Pashamova, Vice President. Our dependence on our key personnel is heightened by the fact that we have a relatively small number of employees and the loss of any key person could harm our entire business, financial condition, cash flow and results of operations. In particular, the loss of the services of Lloyd McAdams or Joseph E. McAdams could seriously harm our business.

Our incentive compensation plan may create an incentive to increase the risk of our mortgage portfolio in an attempt to increase compensation.

In addition to their base salaries, some management and key employees are eligible to earn incentive compensation for each fiscal year pursuant to our 2002 Incentive Plan. Under the 2002 Incentive Plan, the aggregate amount of compensation that may be earned by these employees equals a percentage of net income, before incentive compensation, in excess of the amount that would produce an annualized return on average net worth equal to the ten-year U.S. Treasury Rate plus 1%. In any fiscal quarter in which our net income is an amount less than the amount necessary to earn this threshold return, we calculate negative incentive compensation for that fiscal quarter which will be carried forward and will offset future incentive compensation earned under the 2002 Incentive Plan, but only with respect to those participants who were participants during the fiscal quarter(s) in which negative incentive compensation was generated. Although negative incentive compensation is used to offset future incentive compensation, as our management evaluates different mortgage-related assets for our investment, there is a risk that management will cause us to assume more risk than is prudent.

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Risks Related to REIT Compliance and Other Tax Matters

If we are disqualified as a REIT, we will be subject to tax as a regular corporation and face substantial tax liability.

We believe that, since our IPO in 1998, we have operated so as to qualify as a REIT under the Code and we intend to continue to meet the requirements for taxation as a REIT. Nevertheless, we may not remain qualified as a REIT in the future. Qualification as a REIT involves the application of highly technical and complex Code provisions for which only a limited number of judicial or administrative interpretations exist. Even a technical or inadvertent mistake could require us to pay a penalty or jeopardize our REIT status. Furthermore, Congress or the Internal Revenue Service, or IRS, might change tax laws or regulations and the courts might issue new rulings, in each case potentially having retroactive effects that could make it more difficult or impossible for us to qualify as a REIT. If we fail to qualify as a REIT in any tax year, then:

we would be taxed as a regular domestic corporation, which, among other things, means being unable to deduct distributions to stockholders in computing taxable income and being subject to federal income tax on our taxable income at regular corporate rates;

any resulting tax liability could be substantial and would reduce the amount of cash available for distribution to stockholders; and

unless we were entitled to relief under applicable statutory provisions, we could be disqualified from treatment as a REIT for the subsequent four taxable years following the year during which we lost our qualification and thus our cash available for distribution to stockholders would be reduced for each of the years during which we do not qualify as a REIT.

Complying with REIT requirements may cause us to forego otherwise attractive opportunities.

In order to qualify as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, our sources of income, the nature and diversification of our MBS and other assets, the amounts we distribute to our stockholders and the ownership of our stock. We may also be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution. Thus, compliance with REIT requirements may hinder our ability to operate solely on the basis of maximizing profits.

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

The REIT provisions of the Code may substantially limit our ability to hedge MBS and related borrowings by requiring us to limit our income in each year from qualifying and non-qualifying hedges, together with any other income not generated from qualified sources, to less than 25% of our gross income. In addition, we must limit our aggregate income from non-qualifying hedging, fees and certain other non-qualifying sources, other than from qualified REIT real estate assets or qualified hedges, to less than 5% of our annual gross income. As a result, we may in the future have to limit our use of advantageous hedging techniques or implement those hedges through a taxable REIT subsidiary. This could result in greater risks associated with changes in interest rates than we would otherwise want to incur. If we were to violate the 25% or 5% limitations, we may have to pay a penalty tax equal to the amount of income in excess of those limitations, multiplied by a fraction intended to reflect our profitability. If we fail to satisfy the 25% and 5% limitations, unless our failure was due to reasonable cause and not due to willful neglect, we could lose our REIT status for federal income tax purposes.

Complying with REIT requirements may force us to liquidate otherwise attractive investments or to make investments inconsistent with our business plan.

In order to qualify as a REIT, we must also determine that at the end of each calendar quarter at least 75% of the value of our assets consists of cash, cash items, government securities and qualified REIT real estate assets. The remainder of our investment in securities generally cannot include more than 10% of the outstanding voting

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securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets can consist of the securities of any one issuer. The 5% and 10% limitations described above will apply to our investment in Belvedere Trust unless Belvedere Trust is a qualified REIT subsidiary of ours (i.e., we own 100% of Belvedere Trust's outstanding stock), Belvedere Trust is a qualified REIT or Belvedere Trust is a taxable REIT subsidiary of ours. If we fail to comply with these requirements, we must dispose of a portion of our assets within 30 days after the end of the calendar quarter in order to avoid losing our REIT status and suffering adverse tax consequences. The need to comply with these gross income and asset tests may cause us to acquire other assets that are qualifying real estate assets for purposes of the REIT requirements that are not part of our overall business strategy and might not otherwise be the best investment alternative for us.

Complying with REIT requirements may force us to borrow to make distributions to stockholders.

As a REIT, we must distribute 90% of our annual taxable income (subject to certain adjustments) to our stockholders. From time to time, we may generate taxable income greater than our net income for financial reporting purposes from, among other things, amortization of capitalized purchase premiums, or our taxable income may be greater than our cash flow available for distribution to stockholders. For example, our taxable income would exceed our net income for financial reporting purposes to the extent that compensation paid to our Principal Executive Officer and our other four highest paid officers exceeds \$1 million for any such officer for any calendar year under Section 162(m) of the Code. Since payments under our 2002 Incentive Plan do not qualify as performance-based compensation under Section 162(m), a portion of the payments made under the 2002 Incentive Plan to certain of our officers would not be deductible for federal income tax purposes under such circumstances. If we do not have other funds available in these situations, we may be unable to distribute substantially all of our taxable income as required by the REIT provisions of the Code. Thus, we could be required to borrow funds, sell a portion of our MBS at disadvantageous prices or find another alternative source of funds. These alternatives could increase our costs or reduce our equity.

Dividends payable by REITs do not qualify for the reduced tax rates.

Tax legislation enacted in 2003 reduced the maximum United States federal tax rate on certain corporate dividends paid to individuals and other non-corporate taxpayers to 15% (through 2010). Dividends paid by REITs to these stockholders are generally not eligible for these reduced rates. Although this legislation does not adversely affect the taxation of REITs or dividends paid by REITs, the more favorable rates applicable to non-REIT corporate dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the stock of REITs, including our common stock.

The tax imposed on REITs engaging in prohibited transactions will limit our ability to engage in transactions, including certain methods of securitizing loans, which would be treated as sales for federal income tax purposes.

A REIT's net income from prohibited transactions is subject to a 100% tax. In general, prohibited transactions are sales or other dispositions of property, other than foreclosure property but including any mortgage loans, held in inventory primarily for sale to customers in the ordinary course of business. We might be subject to this tax if we were to sell a loan or securitize loans in a manner that was treated as a sale of such inventory for federal income tax purposes. Therefore, in order to avoid the prohibited transactions tax, we may choose not to engage in certain sales of loans other than through a taxable REIT subsidiary and may limit the structures we utilize for our securitization transactions even though such sales or structures might otherwise be beneficial for us. In addition, this prohibition may limit our ability to restructure our investment portfolio of mortgage loans from time to time, even if we believe that it would be in our best interest to do so.

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Failure to maintain an exemption from the Investment Company Act would harm our results of operations.

We believe that we conduct our business in a manner that allows us to avoid being regulated as an investment company under the Investment Company Act of 1940, as amended. If we fail to continue to qualify for an exemption from registration as an investment company, our ability to use leverage would be substantially reduced and we would be unable to conduct our business as planned. The Investment Company Act exempts entities that are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. Under the SEC's current interpretation, qualification for this exemption generally requires us to maintain at least 55% of our assets directly in qualifying real estate interests. MBS that do not represent all the certificates issued with respect to an underlying pool of mortgages may be treated as securities separate from the underlying mortgage loans and thus may not qualify for purposes of the 55% requirement. Therefore, our ownership of these MBS is limited by the Investment Company Act. In meeting the 55% requirement under the Investment Company Act, we treat as qualifying interests MBS issued with respect to an underlying pool for which we hold all issued certificates. If the SEC or its staff adopts a contrary interpretation, we could be required to sell a substantial amount of our MBS under potentially adverse market conditions. Further, in order to maintain our exemption from registration as an investment company, we may be precluded from acquiring MBS whose yield is somewhat higher than the yield on MBS that could be purchased in a manner consistent with the exemption.

We may incur excess inclusion income that would increase the tax liability of our stockholders.

In general, dividend income that a tax-exempt entity receives from us should not constitute unrelated business taxable income as defined in Section 512 of the Code. If we realize excess inclusion income and allocate it to stockholders, however, then this income would be fully taxable as unrelated business taxable income under Section 512 of the Code. If the stockholder is foreign, it would generally be subject to United States federal income tax withholding on this income without reduction pursuant to any otherwise applicable income tax treaty. United States stockholders would not be able to offset such income with their operating losses.

We generally structure our borrowing arrangements in a manner designed to avoid generating significant amounts of excess inclusion income. However, excess inclusion income could result if we held a residual interest in a REMIC. Excess inclusion income also may be generated if we were to issue debt obligations with two or more maturities and the terms of the payments on these obligations bore a relationship to the payments that we received on our mortgage loans or MBS securing those debt obligations. For example, we may engage in non-REMIC CMO securitizations. We also enter into various repurchase agreements that have differing maturity dates and afford the lender the right to sell any pledged mortgage securities if we default on our obligations. The IRS may determine that these transactions give rise to excess inclusion income that should be allocated among our stockholders. We may invest in equity securities of other REITs and it is possible that we might receive excess inclusion income from those investments. Some types of entities, including, without limitation, voluntarily employee benefit associations and entities that have borrowed funds to acquire their shares of our stock, may be required to treat a portion of or all of the dividends they receive from us as unrelated business taxable income.

Misplaced reliance on legal opinions or statements by issuers of MBS and government securities could result in a failure to comply with REIT gross income or asset tests.

When purchasing MBS and government securities, we may rely on opinions of counsel for the issuer or sponsor of such securities, or statements made in related offering documents, for purposes of determining whether and to what extent those securities constitute REIT real estate assets for purposes of the REIT asset tests and produce income that qualifies under the REIT income tests. The inaccuracy of any such opinions or statements may harm our REIT qualification and result in significant corporate level tax.

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Additional Risk Factors

We may not be able to use the money we raise from time to time to acquire investments at favorable prices.

We intend to seek to raise additional capital from time to time if we determine that it is in our best interests and the best interests of our stockholders, including through public offerings of our stock. The net proceeds of any offering could represent a significant increase in our equity. Depending on the amount of leverage that we use, the full investment of the net proceeds of any offering might result in a substantial increase in our total assets. There can be no assurance that we will be able to invest all of such additional funds in mortgage-related assets at favorable prices. We may not be able to acquire enough mortgage-related assets to become fully invested after an offering, or we may have to pay more for MBS than we have historically. In either case, the return that we earn on stockholders' equity may be reduced.

We have not established a minimum dividend payment level for our common stockholders and there are no assurances of our ability to pay dividends to them in the future.

We intend to pay quarterly dividends and to make distributions to our common stockholders in amounts such that all or substantially all of our taxable income in each year, subject to certain adjustments, is distributed. This, along with other factors, should enable us to qualify for the tax benefits accorded to a REIT under the Code. We have not established a minimum dividend payment level for our common stockholders and our ability to pay dividends may be harmed by the risk factors described in this Annual Report on Form 10-K. All distributions to our common stockholders will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our board of directors may deem relevant from time to time. There are no assurances of our ability to pay dividends in the future.

If we raise additional capital, our earnings per share and dividends per share may decline since we may not be able to invest all of the new capital during the quarter in which additional shares are sold and possibly the entire following calendar quarter.

Our charter does not permit ownership of over 9.8% of our common or preferred stock and attempts to acquire our common or preferred stock in excess of the 9.8% limit are void without prior approval from our board of directors.

For the purpose of preserving our REIT qualification and for other reasons, our charter prohibits direct or constructive ownership by any person of more than 9.8% of the lesser of the total number or value of the outstanding shares of our common stock or more than 9.8% of the outstanding shares of our preferred stock. Our charter's constructive ownership rules are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than 9.8% of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of 9.8% of the outstanding stock and thus be subject to our charter's ownership limit. Any attempt to own or transfer shares of our common or preferred stock in excess of the ownership limit without the consent of the board of directors shall be void and will result in the shares being transferred by operation of law to a charitable trust. Our board of directors has granted four unrelated third party institutional investors exemptions from the 9.8% ownership limitation as set forth in our charter documents. These exemptions permit these entities to hold up to 20.0% and 20.0%, respectively, of our Series A Preferred Stock and 11.59% of our common stock.

Because provisions contained in Maryland law, our charter and our bylaws may have an anti-takeover effect, investors may be prevented from receiving a control premium for their shares.

Provisions contained in our charter and bylaws, as well as Maryland corporate law, may have anti-takeover effects that delay, defer or prevent a takeover attempt, which may prevent stockholders from receiving a control premium for their shares. For example, these provisions may defer or prevent tender offers for our common

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stock or purchases of large blocks of our common stock, thereby limiting the opportunities for our stockholders to receive a premium for their common stock over then-prevailing market prices. These provisions include the following:

Ownership limit. The ownership limit in our charter limits related investors including, among other things, any voting group, from acquiring over 9.8% of our common stock or more than 9.8% of our preferred stock without our permission.

Preferred Stock. Our charter authorizes our board of directors to issue preferred stock in one or more classes and to establish the preferences and rights of any class of preferred stock issued. These actions can be taken without soliciting stockholder approval.

Maryland business combination statute. Maryland law restricts the ability of holders of more than 10% of the voting power of a corporation's shares to engage in a business combination with the corporation.

Maryland control share acquisition statute. Maryland law limits the voting rights of control shares of a corporation in the event of a control share acquisition.

Future offerings of debt securities, which would be senior to our common stock, Series A Preferred Stock and Series B Preferred Stock upon liquidation, or equity securities, which would dilute our existing stockholders and may be senior to our common stock, Series A Preferred Stock and Series B Preferred Stock for the purposes of dividend distributions, may harm the market price of our common stock, Series A Preferred Stock or Series B Preferred Stock.

In the future, we may attempt to increase our capital resources by making additional offerings of debt or equity securities, including commercial paper, medium-term notes, senior or subordinated notes and classes of preferred stock or common stock. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common stock. Our preferred stock may have a preference on dividend payments that could limit our ability to make a dividend distribution to the holders of our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, our common stockholders bear the risk of our future offerings reducing the market price of our common stock.

Our charter provides that we may issue up to 20 million shares of preferred stock in one or more series. The issuance of additional preferred stock on parity with or senior to the Series A Preferred Stock or Series B Preferred Stock could have the effect of diluting the amounts we may have available for distribution to holders of the Series A Preferred Stock or Series B Preferred Stock. The Series A Preferred Stock and Series B Preferred Stock will be subordinated to all our existing and future debt. Thus, our Series A Preferred Stockholders and our Series B Preferred Stockholders bear the risk of our future offerings reducing the market price of our Series A Preferred Stock or Series B Preferred Stock.

We may issue additional shares of common stock or shares of preferred stock that are convertible into common stock. If we issue a significant number of shares of common stock or convertible preferred stock in a short period of time, there could be a dilution of the existing common stock and a decrease in the market price of the common stock.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

We sublease approximately 5,500 square feet of office space in Santa Monica, California under a sublease agreement with PIA that expires in 2012. BT Management Holding Corporation subleases approximately 2,305

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square feet of office space in San Francisco, California, for Belvedere Trust under an agreement with Keefe, Bruyette and Woods, Inc. that expires July 31, 2008. We believe these facilities are adequate for our intended level of operations.

Item 3. LEGAL PROCEEDINGS

We are not a party to any material pending legal proceedings.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2007.

Table of Contents**PART II****Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Information**

Our Series A Preferred Stock began trading under the symbol ANHPrA on the New York Stock Exchange on November 8, 2004. The high and low sale prices for our Series A Preferred Stock, as reported by the New York Stock Exchange, for the periods indicated are as follows:

	2006		2007	
	High	Low	High	Low
First Quarter	\$ 24.92	\$ 24.06	\$ 25.91	\$ 24.39
Second Quarter	\$ 25.10	\$ 23.70	\$ 25.40	\$ 24.70
Third Quarter	\$ 25.05	\$ 23.90	\$ 25.10	\$ 16.90
Fourth Quarter	\$ 25.60	\$ 24.75	\$ 24.25	\$ 22.50

Our Series B Preferred Stock began trading under the symbol ANHPrB on the New York Stock Exchange on January 30, 2007. The high and low sale prices for our Series B Preferred Stock, as reported by the New York Stock Exchange, for the periods indicated are as follows:

	2006		2007	
	High	Low	High	Low
First Quarter	\$	\$	\$ 26.15	\$ 24.51
Second Quarter	\$	\$	\$ 26.44	\$ 24.80
Third Quarter	\$	\$	\$ 25.00	\$ 14.11
Fourth Quarter	\$	\$	\$ 21.50	\$ 17.10

Our common stock began trading under the symbol ANH on the New York Stock Exchange on May 9, 2003. Our common stock previously traded under the symbol ANH on the American Stock Exchange. Prior to March 17, 1998, there had been no public market for our common stock. The high and low sale prices for our common stock, as reported by the New York Stock Exchange, for the periods indicated are as follows:

	2006		2007	
	High	Low	High	Low
First Quarter	\$ 8.43	\$ 7.35	\$ 9.77	\$ 8.39
Second Quarter	\$ 8.30	\$ 7.41	\$ 10.03	\$ 8.96
Third Quarter	\$ 8.46	\$ 7.73	\$ 9.24	\$ 3.90
Fourth Quarter	\$ 9.76	\$ 8.27	\$ 8.50	\$ 5.46

Holders

As of March 7, 2008, there were approximately 6 record holders of our Series A Preferred Stock. On March 7, 2008, the last reported sale price of our Series A Preferred Stock on the New York Stock Exchange was \$21.70 per share. As of March 7, 2008, there were approximately 5 record holders of our Series B Preferred Stock. On March 7, 2008, the last reported sale price of our Series B Preferred Stock on the New York Stock Exchange was \$17.60 per share. As of March 7, 2008, there were approximately 676 record holders of our common stock. On March 7, 2008, the last reported sale price of our common stock on the New York Stock Exchange was \$6.00 per share.

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We pay cash dividends on a quarterly basis. The following table lists the cash dividends declared on each share of our Series A Preferred Stock, on each share of our Series B Preferred Stock and on each share of our common stock for our most recent two fiscal years. The dividends listed below were based primarily on the board of directors' evaluation of earnings and consideration of actions necessary to maintain our REIT status for each listed quarter and were declared on the date indicated:

	Cash Dividends Per Series A Preferred Share	Date Dividends Declared	Cash Dividends Per Series B Preferred Share	Date Dividends Declared	Cash Dividends Per Common Share	Date Dividends Declared
2006						
First quarter ended March 31, 2006	\$ 0.539063	December 15, 2005	\$	N/A	\$ 0.02	April 12, 2006
Second quarter ended June 30, 2006	\$ 0.539063	April 12, 2006	\$	N/A	\$ 0.02	July 12, 2006
Third quarter ended September 30, 2006	\$ 0.539063	July 12, 2006	\$	N/A	\$ 0.02	October 11, 2006
Fourth quarter ended December 31, 2006(1)	\$ 0.539063	October 11, 2006	\$	N/A	\$ 0.02	December 13, 2006
2007						
First quarter ended March 31, 2007	\$ 0.539063	December 31, 2006	\$ 0.282118	March 23, 2007	\$ 0.05	April 13, 2007
Second quarter ended June 30, 2007	\$ 0.539063	April 13, 2007	\$ 0.390625	April 13, 2007	\$ 0.05	July 12, 2007
Third quarter ended September 30, 2007	\$ 0.539063	July 12, 2007	\$ 0.390625	July 12, 2007	\$ 0.05	October 11, 2007
Fourth quarter ended December 31, 2007(2)	\$ 0.539063	October 11, 2007	\$ 0.390625	October 11, 2007	\$ 0.12	December 12, 2007

- (1) The Series A Preferred Stock dividend was paid on January 15, 2007 to holders of record as of the close of business on December 29, 2006. The common stock dividend was paid on January 19, 2007 to holders of record as of the close of business on December 29, 2006. Our Series B Preferred Stock began trading under the symbol ANHPrB on the New York Stock Exchange on January 30, 2007.
- (2) The Series A Preferred Stock dividend was paid on January 15, 2008 to holders of record as of the close of business on December 31, 2007. The Series B Preferred Stock dividend was paid on January 15, 2008 to holders of record as of the close of business on December 31, 2007. The common stock dividend was paid on January 18, 2008 to holders of record as of the close of business on December 24, 2007.

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Total Return Comparison

The following graph presents a total return comparison of our common stock with the Standard & Poor's 500 Index and the National Association of Real Estate Investment Trusts, Inc. Mortgage REIT Index:

	12/31/2002	12/31/2003	12/31/2004	12/31/2005	12/31/2006	12/31/2007
Anworth Mortgage Asset Corp	\$ 100	\$ 129	\$ 109	\$ 81	\$ 102	\$ 91
S&P Composite-500 Index	\$ 100	\$ 129	\$ 143	\$ 150	\$ 173	\$ 183
NAREIT Mortgage REIT Index	\$ 100	\$ 157	\$ 186	\$ 143	\$ 171	\$ 99

The total return reflects stock price appreciation, if any, and the value of dividends for our common stock and for each of the comparative indices. The graph assumes that \$100 was invested on December 31, 2002 (or the first trading day thereafter) in our common stock, that \$100 was invested in each of the indices on December 31, 2002 (or the first trading day thereafter) and that all dividends were reinvested. The total return performance shown in this graph is not necessarily indicative of and is not intended to suggest future total return performance. Measurement points are at the last trading day of the fiscal years represented above.

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The selected financial data as of December 31, 2007 and 2006 and for the years ended December 31, 2007, 2006 and 2005 are derived from our audited financial statements included in this Annual Report on Form 10-K. The selected financial data as of December 31, 2005, 2004 and 2003 and for the years ended December 31, 2004 and 2003 are derived from audited financial statements not included in this Annual Report on Form 10-K. You should read these selected financial data together with Management's Discussion and Analysis of Financial Condition and Results of Operations and our audited and unaudited financial statements and notes thereto that are included in this Annual Report on Form 10-K beginning on page F-1.

	Year Ended December 31,				
	2003	2004	2005	2006	2007
(amounts in thousands, except for per share data and days)					
Consolidated Statements of Income Data					
Days in period	365	366	365	365	365
Interest income net of amortization of premium and discount	\$ 100,077	\$ 127,239	\$ 159,248	\$ 206,287	\$ 248,831
Interest expense	(45,661)	(70,184)	(131,099)	(202,037)	(224,884)
Net interest income	\$ 54,416	\$ 57,055	\$ 28,149	\$ 4,250	\$ 23,947
Net gain (loss) on sale of assets	3,497	100		(10,207)	(23,442)
Net loss on derivative instruments					(147)
Expenses	(7,718)	(7,175)	(5,874)	(5,484)	(5,536)
Income (loss) from continuing operations	\$ 50,195	\$ 49,980	\$ 22,275	\$ (11,441)	\$ (5,178)
Income (loss) from discontinued operations		5,825	6,610	(2,763)	(151,288)
Net income (loss)	\$ 50,195	\$ 55,805	\$ 28,885	\$ (14,204)	\$ (156,466)
Dividends on preferred stock		(369)	(3,901)	(4,044)	(4,749)
Net income (loss) available to common stockholders	\$ 50,195	\$ 55,436	\$ 24,984	\$ (18,248)	\$ (161,215)
Basic earnings (loss) per common share:					
Continuing operations	\$ 1.52	\$ 1.10	\$ 0.39	\$ (0.34)	\$ (0.21)
Discontinued operations		0.13	0.14	(0.06)	(3.26)
Total basic earnings (loss) per common share	\$ 1.52	\$ 1.23	\$ 0.53	\$ (0.40)	\$ (3.47)
Average number of shares outstanding	32,927	45,244	47,103	45,430	46,483
Diluted earnings (loss) per common share:					
Continuing operations	\$ 1.52	\$ 1.10	\$ 0.39	\$ (0.34)	\$ (0.21)
Discontinued operations		0.12	0.14	(0.06)	(3.26)
Total diluted earnings (loss) per common share	\$ 1.52	\$ 1.22	\$ 0.53	\$ (0.40)	\$ (3.47)
Average number of diluted shares outstanding	33,112	45,329	47,128	45,430	46,483

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	2003	2004	As of December 31, 2005	2006	2007
	(amounts in thousands, except for per share data)				
Consolidated Balance Sheets Data					
Agency MBS	\$ 4,245,853	\$ 4,588,541	\$ 4,524,683	\$ 4,678,907	\$ 4,662,547
Assets of discontinued operations	101	2,702,910	2,622,375	1,858,789	38
Total assets	\$ 4,263,274	\$ 7,319,070	\$ 7,184,249	\$ 6,687,389	\$ 4,797,515
Repurchase agreements (Anworth)	\$ 3,775,691	\$ 4,172,930	\$ 4,099,410	\$ 4,329,921	\$ 4,227,100
Junior subordinated notes			37,380	37,380	37,380
Liabilities of discontinued operations		2,603,133	2,517,727	1,756,060	7,834
Total liabilities	\$ 3,805,877	\$ 6,812,033	\$ 6,701,150	\$ 6,196,387	\$ 4,367,959
Series B Preferred Stock					28,108
Stockholders' equity (common and Series A preferred)	\$ 457,397	\$ 507,036	\$ 483,099	\$ 491,002	\$ 401,448
Number of common shares outstanding	42,707	46,497	45,397	45,609	57,289
Book value per common share	\$ 10.71	\$ 10.31	\$ 9.61	\$ 9.74	\$ 6.15

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Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our financial statements and the related notes included in Item 8 Financial Statements and Supplementary Information in this Annual Report on Form 10-K. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors including, but not limited to, those disclosed in Item 1A Risk Factors and elsewhere in this Annual Report on Form 10-K.

General

We were formed in October 1997 and commenced operations on March 17, 1998. We are in the business of investing primarily in mortgage-related assets including mortgage pass-through certificates, collateralized mortgage obligations, mortgage loans and other securities representing interests in, or obligations backed by, pools of mortgage loans which can be readily financed. Our principal business objective is to generate net income for distribution to stockholders based upon the spread between the interest income on our mortgage-related assets and the costs of borrowing to finance our acquisition of these assets.

We are organized for tax purposes as a REIT. Accordingly, we generally distribute substantially all of our earnings to stockholders without paying federal or state income tax at the corporate level on the distributed earnings. At December 31, 2007, our qualified REIT assets (real estate assets, as defined in the Code, cash and cash items and government securities) were greater than 90% of our total assets, as compared to the Code requirement that at least 75% of our total assets must be qualified REIT assets. Greater than 99% of our 2007 revenue qualifies for both the 75% source of income test and the 95% source of income test under the REIT rules. We believe we met all REIT requirements regarding the ownership of our common stock and the distributions of our net income. Therefore, we believe that we continue to qualify as a REIT under the provisions of the Code.

Our continuing operations consist of the following portfolios: Agency mortgage-backed securities, or Agency MBS, and Non-Agency mortgage-backed securities, or Non-Agency MBS. Our discontinued operations consisted of the following portfolios: Belvedere Trust's residential real estate loans, or BT Residential Loans, and Belvedere Trust's other mortgage-backed securities, or BT Other MBS.

In November 2003, we formed Belvedere Trust Mortgage Corporation, or Belvedere Trust, to acquire mortgage loans and other mortgage-related assets. Through May 2005, Belvedere Trust securitized a substantial amount of those mortgage loans and retained a portion of the MBS while selling the balance to third parties in the secondary market. Since 2005, Belvedere Trust invested in senior and subordinated tranches from other issuers' securitizations.

Due to recent liquidity and credit problems surrounding the mortgage markets generally, Belvedere Trust received, during the third quarter of 2007, margin calls from its lenders that it was unable to meet, resulting in defaults under lines of credit pursuant to which it remitted distributions from the underlying collateral to its lenders. On September 5, 2007, following discussions with financial advisers retained by Belvedere Trust in connection with the issues facing the credit markets, it was determined that obtaining alternate financing for Belvedere Trust was unlikely and we concluded that a material charge for impairment with respect to all of Belvedere Trust's assets was required under generally accepted accounting principles, or GAAP. In September 2007, we developed a plan to dispose of Belvedere Trust. In December 2007, Belvedere Trust received several notices of default from its remaining counterparties which it was unable to meet and, as a result, its remaining assets were either seized or written off. Belvedere Trust, which is reported as a discontinued operation in the financial statements included in this Annual Report on Form 10-K, has three claims against it totaling approximately \$8 million, which have been contested, related to repurchase agreement transactions. Anworth is neither a co-party to nor a guarantor of Belvedere Trust's repurchase agreements or any claims against Belvedere Trust.

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At December 31, 2007, we had total assets of \$4.8 billion. Our Agency MBS portfolio, consisting of \$4.7 billion, was distributed as follows: 20% agency adjustable-rate MBS, 62% agency hybrid adjustable-rate MBS, 18% agency fixed-rate MBS and less than 1% agency floating-rate CMOs. Our Non-Agency MBS portfolio consisted of \$43 million of floating-rate CMOs. Stockholders' equity available to common stockholders at December 31, 2007 was approximately \$352.5 million, or \$6.15 per share. The \$352.5 million equals total stockholders' equity of \$401.4 million less the Series A Preferred Stock liquidating value of approximately \$46.9 million and less the difference between the Series B Preferred Stock liquidating value of \$30.1 million and the proceeds from its sale of \$28.1 million. For the year ended December 31, 2007, we reported a net loss of \$156.5 million. Net loss to common stockholders was \$161.2 million, or a net loss of \$(3.47) per diluted share. This includes a loss of approximately \$23.4 million on the sale of Agency MBS and Non-Agency MBS and a net loss on discontinued operations of approximately \$151.3 million. The net loss on discontinued operations also includes approximately \$8 million from three claims, which have been contested, related to repurchase agreement transactions. Relative to the contested claims, we believe that there will be an increase to earnings after the dissolution of Belvedere Trust, although there can be no assurances as to the timing of such dissolution. Anworth is neither a co-party to nor a guarantor of Belvedere Trust's repurchase agreements or any claims against Belvedere Trust.

Results of Operations

Years Ended December 31, 2007 and 2006

For the year ended December 31, 2007, our net loss was \$156.5 million. Our net loss to common stockholders was \$161.2 million, or a net loss of \$(3.47) per diluted share, based on an average of 46.5 million shares outstanding. This includes a loss from continuing operations of \$5.2 million (due primarily to a loss of \$23.4 million on the sale of approximately \$904 million of our Agency MBS and Non-Agency MBS) and a loss from discontinued operations of \$151.3 million (due to the sales, seizures by lenders and write-offs of Belvedere Trust's assets). This net loss on discontinued operations also includes approximately \$8 million from three claims against Belvedere Trust, which have been contested, related to repurchase agreement transactions. Anworth is neither a co-party to nor a guarantor of Belvedere Trust's repurchase agreements or any claims against Belvedere Trust. For the year ended December 31, 2006, our net loss was \$14.2 million. Our net loss to common stockholders was \$18.2 million, or a net loss of \$(0.40) per diluted share, based on an average of 45.4 million shares outstanding. This includes a loss from continuing operations of \$11.4 million (due primarily to a loss of \$10.2 million on the sale of approximately \$398 million of our Agency MBS) and a loss from discontinued operations of \$2.8 million.

Continuing Operations

Net interest income for the year ended December 31, 2007 totaled \$23.9 million or 8.9% of gross income, compared to \$4.3 million, or 1.8% of gross income, for the year ended December 31, 2006. The increase in net interest income is due primarily to the increase in interest rates of our MBS investments. Net interest income is comprised of the interest income earned on mortgage investments (net of premium amortization expense) less interest expense from borrowings. Interest income net of premium amortization expense for the year ended December 31, 2007 was \$248.8 million, compared to \$206.3 million for the year ended December 31, 2006, an increase of 20.6%. Interest expense for the year ended December 31, 2007 was \$224.9 million, compared to \$202.0 million for the year ended December 31, 2006, an increase of 11.3%. The smaller increase in interest expense relative to the increase in interest income was due primarily to the increases in short-term rates later in the year which we believe arose from liquidity and credit concerns surrounding the mortgage markets generally, which in turn caused lenders to be more cautious and resulted in increases in the borrowing rate as well as more limited financing.

During the year ended December 31, 2007, premium amortization expense for Anworth decreased \$6.5 million, or 23.6%, from \$27.6 million during the year ended December 31, 2006 to \$21.1 million. During the year ended December 31, 2007, the decrease in premium amortization expense for Anworth resulted from a decrease of the constant prepayment rate of its portfolio.

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The table below shows the approximate constant prepayment rate of our Agency MBS and Non-Agency MBS:

Portfolio	Year Ended December 31, 2007				Year Ended December 31, 2006			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Agency MBS and Non-Agency MBS	24%	25%	23%	18%	25%	29%	26%	26%

During the year ended December 31, 2007, we sold approximately \$904 million of Agency MBS and Non-Agency MBS, resulting in a loss of approximately \$23.4 million. During the year ended December 31, 2006, we sold approximately \$398 million in face amount of Agency MBS, resulting in a loss of approximately \$10.2 million, as part of our asset/liability management program. The proceeds from the sale were used to invest in higher-yielding Agency MBS.

Total expenses were \$5.5 million for the year ended December 31, 2007, compared to \$5.5 million for the year ended December 31, 2006. The increase of \$52 thousand in total expenses was due primarily to an increase in compensation costs of \$139 thousand, an increase in Other expenses of \$407 thousand partially offset by a decrease in compensation costs relating to amortization of restricted stock of \$494 thousand.

Discontinued Operations

For the year ended December 31, 2007, there was a net loss from discontinued operations of \$151.3 million compared to a net loss of \$2.8 million for the year ended December 31, 2006. The net loss in 2007 from discontinued operations of \$151.3 million was due to the sales, seizures by lenders and write-offs of Belvedere Trust's assets. This net loss on discontinued operations also includes approximately \$8 million from three claims against Belvedere Trust, which have been contested, related to repurchase agreement transactions. Anworth is neither a co-party to nor a guarantor of Belvedere Trust's repurchase agreements or any claims against Belvedere Trust.

Net interest income (expense) for the year ended December 31, 2007 was \$4.4 million compared to \$(2.0) million for the year ended December 31, 2006. Net interest income is comprised of interest income earned on mortgage investments (net of premium amortization expense) less interest expense on borrowings. Interest income net of premium amortization expense for the year ended December 31, 2007 was \$66.7 million compared to \$103.1 million for the year ended December 31, 2006, a decrease of 35.3%. Interest expense for the year ended December 31, 2007 was \$62.3 million compared to \$105.1 million for the year ended December 31, 2006, a decrease of 40.7%. The decrease in both interest income and interest expense was due primarily to the reduction in the mortgage investments and related borrowings.

During the year ended December 31, 2007, Belvedere Trust realized a loss of approximately \$151.2 million on the sale of and impairment of its assets. During the year ended December 31, 2006, Belvedere Trust realized a gain of approximately \$2.6 million on the sale of \$103 million in face amount of BT Other MBS as part of its asset/liability management program and were designed to reduce credit exposure.

Total expenses for discontinued operations were \$4.5 million for the year ended December 31, 2007 compared to \$3.4 million for the year ended December 31, 2006. The increase in expenses of approximately \$1.1 million was due primarily to an increase in loan loss reserve expenses of approximately \$0.9 million and the write-off of shelf registration costs (for the BellaVista shelf) of approximately \$0.5 million.

Years Ended December 31, 2006 and 2005

For the year ended December 31, 2006, our net loss was \$14.2 million. Our net loss to common stockholders was \$18.2 million, or a net loss of \$(0.40) per diluted share, based on an average of 45.4 million shares outstanding. This includes a loss from continuing operations of \$11.4 million (due primarily to a loss of

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\$10.2 million on the sale of approximately \$398 million of our Agency MBS) and a loss from discontinued operations of \$2.8 million. For the year ended December 31, 2005, our net income was \$28.9 million and our net income available to common stockholders was \$25 million, or \$0.53 per diluted share, based on an average of 47.1 million shares outstanding. This includes income from continuing operations of \$22.3 million and income from discontinued operations of \$6.6 million.

Continuing Operations

Net interest income for the year ended December 31, 2006 totaled \$4.3 million or 1.8 % of gross income, compared to \$28.1 million, or 14.1 % of gross income, for the year ended December 31, 2005. The decline in net interest income is due primarily to the increase in short-term interest rates during most of the year and the mismatch between longer maturities on the mortgage-related assets and the shorter maturities on the related liabilities that finance those assets. Net interest income is comprised of the interest income earned on mortgage investments (net of premium amortization expense) less interest expense from borrowings. Interest income net of premium amortization expense for the year ended December 31, 2006 was \$206.3 million, compared to \$159.2 million for the year ended December 31, 2005, an increase of 29.6%. Interest expense for the year ended December 31, 2006 was \$202.0 million, compared to \$131.1 million for the year ended December 31, 2005, an increase of 54.1%. The increase in both interest income and interest expense was due primarily to the increase in short-term interest rates during most of the year.

During the year ended December 31, 2006, premium amortization expense for Anworth decreased \$13.2 million, or 32.4%, from \$40.8 million during the year ended December 31, 2005 to \$27.6 million. During the year ended December 31, 2006, the decrease in premium amortization expense for Anworth resulted from a decrease of the constant prepayment rate of its portfolio.

The table below shows the approximate constant prepayment rate of our Agency MBS and Non-Agency MBS:

Portfolio	Year Ended December 31, 2006				Year Ended December 31, 2005			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Agency MBS and Non-Agency MBS	25%	29%	26%	26%	27%	31%	36%	32%

During the year ended December 31, 2006, we sold approximately \$398 million in face amount of Agency MBS, resulting in a loss of approximately \$10.2 million, as part of our asset/liability management program. The proceeds from the sale were used to invest in higher-yielding Agency MBS. During the year ended December 31, 2005, we did not sell any of our MBS. During the years ended December 31, 2006 and 2005, we did not have any realized gain or loss on derivative instruments.

Total expenses were \$5.5 million for the year ended December 31, 2006, compared to \$5.9 million for the year ended December 31, 2005. The decrease of \$390 thousand in total expenses was due primarily to a decrease in incentive compensation of \$708 thousand (resulting from a decrease in net income), a decrease in Other expenses of \$82 thousand, partially offset by an increase in compensation costs of \$43 thousand and an increase in compensation costs relating to amortization of restricted stock of \$357 thousand.

Discontinued Operations

For the year ended December 31, 2006, there was a net loss from discontinued operations of \$2.8 million compared to net income of \$6.6 million for the year ended December 31, 2005.

Net interest income (expense) for the year ended December 31, 2006 was \$(2.0) million compared to \$11.1 million for the year ended December 31, 2005. Net interest income is comprised of interest income earned on mortgage investments (net of premium amortization expense) less interest expense on borrowings. Interest

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income net of premium amortization expense for the year ended December 31, 2006 was \$103.1 million compared to \$122.5 million for the year ended December 31, 2005, a decrease of 15.8%. Interest expense for the year ended December 31, 2006 was \$105.1 million compared to \$111.4 million for the year ended December 31, 2005, a decrease of 5.7%. The decrease in both interest income and interest expense was due primarily to the reduction in the mortgage investments and related borrowings, although the decline in interest expense was offset somewhat by the increase in short-term interest rates during most of the year.

During the year ended December 31, 2006, premium amortization expense increased \$2.4 million, or 12.8%, from \$18.7 million during the year ended December 31, 2005 to \$21.1 million. The increase in premium amortization expense resulted primarily from impairment charges of \$3.3 million related to some of Belvedere Trust's interest-only securities.

The table below shows the approximate constant prepayment rate of Belvedere Trust's mortgage-related assets:

Portfolio	Year Ended December 31, 2006				Year Ended December 31, 2005			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
BT Residential Loans	35%	35%	29%	32%	19%	31%	37%	35%
BT Other MBS	10%	8%	13%	7%	21%	16%	17%	19%

During the year ended December 31, 2006, Belvedere Trust realized a gain of approximately \$2.6 million on the sale of \$103 million in face amount of BT Other MBS. Belvedere Trust's sales of BT Other MBS were part of its asset/liability management program and were designed to reduce credit exposure. During the year ended December 31, 2005, Belvedere Trust realized a gain on the sale of securities of \$129 thousand.

Total expenses for discontinued operations were \$3.4 million for the year ended December 31, 2006 compared to \$4.6 million for the year ended December 31, 2005. This decrease was due primarily to a decrease of \$0.5 million related to costs associated with a proposed offering by Belvedere Trust, a decrease of \$0.3 million in fees related to holding loans and subservicing (due primarily to the reduction in the loan portfolio and that no new loans were acquired or securitized in 2006) and a decrease in legal and accounting fees of \$0.1 million.

Financial Condition*Continuing Operations**Agency MBS Portfolio*

At December 31, 2007, we held agency mortgage assets whose amortized cost was approximately \$4.63 billion, consisting primarily of \$3.80 billion of adjustable-rate MBS, \$818 million of fixed-rate MBS and \$9 million of floating-rate CMOs. This amount represents an approximate 1.5% decrease from the \$4.70 billion held at December 31, 2006. Of the adjustable-rate Agency MBS owned by us, 24% were adjustable-rate pass-through certificates whose coupons reset within one year. The remaining 76% consisted of hybrid adjustable-rate MBS whose coupons will reset between one year and five years. Hybrid adjustable-rate MBS have an initial interest rate that is fixed for a certain period, usually three to five years, and thereafter adjust annually for the remainder of the term of the loan.

The following table presents a schedule of our Agency MBS at fair value owned at December 31, 2007 and December 31, 2006, classified by type of issuer (dollar amounts in thousands):

Agency	At December 31, 2007		At December 31, 2006	
	Fair Value	Portfolio Percentage	Fair Value	Portfolio Percentage
Fannie Mae (FNM)	\$ 3,412,030	73.2%	\$ 2,895,583	61.9%
Freddie Mac (FHLMC)	1,215,291	26.1	1,728,525	36.9
Ginnie Mae (GNMA)	35,226	0.7	54,799	1.2
Total Agency MBS:	\$ 4,662,547	100.0%	\$ 4,678,907	100.0%

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The following table classifies our portfolio of Agency MBS owned at December 31, 2007 and December 31, 2006, by type of interest rate index (dollar amounts in thousands):

Index	At December 31, 2007		At December 31, 2006	
	Fair Value	Portfolio Percentage	Fair Value	Portfolio Percentage
One-month LIBOR	\$ 9,369	0.2%	\$ 10,940	0.2%
Six-month LIBOR	52,366	1.1	66,262	1.4
One year LIBOR	3,203,408	68.7	2,877,311	61.5
Six-month Certificate of Deposit	2,101	0.1	3,259	0.1
Six-month Constant Maturity Treasury	766	0.0	1,093	0.0
One-year Constant Maturity Treasury	530,614	11.4	914,451	19.6
Cost of Funds Index	44,516	0.9	55,112	1.2
Fixed-rate	819,407	17.6	750,479	16.0
Total Agency MBS:	\$ 4,662,547	100.0%	\$ 4,678,907	100.0%

The fair values indicated do not include interest earned but not yet paid. With respect to our hybrid adjustable-rate MBS, the fair value of these securities appears on the line associated with the index based on which the security will eventually reset once the initial fixed interest rate period has expired.

At December 31, 2007, our total Agency MBS portfolio had a weighted average coupon of 5.91%. The average coupon of the adjustable-rate securities was 6.10%, the hybrid securities average coupon was 5.85%, the fixed-rate securities average coupon was 5.92% and the CMO floaters average coupon was 5.84%. At December 31, 2006, our total Agency MBS portfolio had a weighted average coupon of 5.63%. The average coupon of the adjustable-rate securities was 5.76%, the hybrid average coupon was 5.49%, the fixed-rate securities average coupon was 5.95% and the CMO floaters average coupon was 6.13%.

At December 31, 2007, the average amortized cost of our agency mortgage-related assets was 101.23%, the average amortized cost of our adjustable-rate securities was 101.30% and the average amortized cost of our fixed-rate securities was 100.88%. Relative to our Agency MBS portfolio at December 31, 2007, the average interest rate on outstanding repurchase agreements was 4.91% and the average days to maturity was 49 days. After adjusting for interest rate swap transactions, the average interest rate on outstanding repurchase agreements was 4.77% and the weighted average term to next rate adjustment was 418 days.

At December 31, 2006, the average amortized cost of our agency mortgage-related assets was 101.55%, the average amortized cost of our adjustable-rate securities was 101.64% and the average amortized cost of our fixed-rate securities was 101.10%. Relative to our Agency MBS and Non-Agency MBS portfolios at December 31, 2006, the average interest rate on outstanding repurchase agreements was 5.36% and the average days to maturity was 90 days. After adjusting for interest rate swap transactions, the average interest rate on outstanding repurchase agreements was 5.19% and the weighted average term to next rate adjustment was 301 days.

At December 31, 2007 and December 31, 2006, the unamortized net premium paid for our Agency MBS was \$56 million and \$72 million, respectively.

At December 31, 2007, the current yield on our Agency MBS portfolio was 5.84% based on a weighted average coupon of 5.91% divided by the average amortized cost of 101.23%. At December 31, 2006, the current yield on our Agency MBS portfolio was 5.54% based on a weighted average coupon of 5.63% divided by the average amortized cost of 101.55%.

We analyze our MBS and the extent to which prepayments impact the yield of the securities. When the rate of prepayments exceeds expectations, we amortize the premiums paid on mortgage assets over a shorter time

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period, resulting in a reduced yield to maturity on our mortgage assets. Conversely, if actual prepayments are less than the assumed constant prepayment rate, the premium would be amortized over a longer time period, resulting in a higher yield to maturity.

Non-Agency MBS Portfolio

At December 31, 2007, our Non-Agency MBS portfolio consisted of \$43 million of CMO floaters with an average coupon of 5.11% which were acquired at par value. At December 31, 2006, our Non-Agency MBS portfolio consisted of \$107 million of CMO floaters with an average coupon of 5.61% which were acquired at par value.

Discontinued Operations

At December 31, 2007, the assets of discontinued operations were either seized by Belvedere Trust's lenders or were written off. At December 31, 2007, the liabilities of discontinued operations consisted of three claims totaling approximately \$8 million against Belvedere Trust, which have been contested, related to repurchase agreement transactions. Anworth is neither a co-party to nor a guarantor of Belvedere Trust's repurchase agreements or any claims against Belvedere Trust. At December 31, 2006, the assets of discontinued operations consisted primarily of the BT Other MBS portfolio of approximately \$162.8 million and the BT Residential Loans portfolio of approximately \$1.68 billion. At December 31, 2006, the liabilities of discontinued operations consisted primarily of repurchase agreements of approximately \$276 million and MBS Issued of approximately \$1.47 billion.

BT Other MBS Portfolio

At December 31, 2007, Belvedere Trust did not have any MBS.

At December 31, 2006, Belvedere Trust's portfolio of BT Other MBS at fair value included securities which are backed by first-lien hybrid and adjustable-rate residential mortgages. These MBS include investment grade and non-investment grade securities with a carrying value of approximately \$162.8 million backed by 29.7% hybrid, 70.0% adjustable-rate and 0.3% fixed-rate mortgages by carrying value. This amount includes approximately \$21.9 million in securities that were retained from Belvedere Trust's first securitization (HYB1) (accounted for as a sale) during the first quarter of 2004 consisting of \$13.3 million in securities rated AAA, \$6.8 million in other investment grade securities and \$1.8 million in non-investment grade securities. The remaining balance of approximately \$140.9 million was securities that were purchased from major issuers and consist of \$127.0 million in investment grade securities and \$13.9 million in non-investment grade securities.

BT Residential Loans Portfolio

At December 31, 2007, Belvedere Trust did not have any residential real estate loans.

At December 31, 2006, Belvedere Trust's residential real estate loans consisted of the following (in thousands):

	Total Residential Real Estate Loans
Residential Real Estate Loans	
Principal balance	\$ 1,652,773
Principal receivable	11
Unamortized premium	30,788
Valuation reserve on real estate owned	(1,050)
Carrying value	\$ 1,682,522

At December 31, 2006, Belvedere Trust's residential real estate loan portfolio was \$1.7 billion, consisting of securitized loans. There were no loans pending securitization. The residential real estate loan portfolio consisted

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of 4,522 loans with an average loan balance of \$365 thousand. The securitized residential real estate loans serve as collateral for \$1.5 billion of MBS issued and \$155 million of repurchase agreement financings.

Hedging

We periodically enter into derivative transactions, in the form of forward purchase commitments and interest rate swaps, which are intended to hedge our exposure to rising rates on funds borrowed to finance our investments in securities. We designate interest rate swap transactions as cash flow hedges. We also periodically enter into derivative transactions, in the form of forward purchase commitments, which are not designated as hedges. To the extent that we enter into hedging transactions to reduce our interest rate risk on indebtedness incurred to acquire or carry real estate assets, any income or gain from the disposition of hedging transactions should be qualifying income for purposes of the 95% gross income test, but not the 75% gross income test.

As part of our asset/liability management policy, we may enter into hedging agreements such as interest rate caps, floors or swaps. These agreements would be entered into to try to reduce interest rate risk and would be designed to provide us with income and capital appreciation in the event of certain changes in interest rates. We review the need for hedging agreements on a regular basis consistent with our capital investment policy. At December 31, 2007, we were a counter-party to swap agreements, which are derivative instruments as defined by the Financial Accounting Standards Board in FASB 133 and FASB 138, with an aggregate notional amount of \$2.04 billion and an average maturity of 2.4 years. We utilize swap agreements to manage interest rate risk and do not anticipate entering into derivative transactions for speculative or trading purposes. In accordance with the swap agreements, we pay a fixed rate of interest during the term of the swap agreements and receive a payment that varies with the three-month LIBOR rate. At December 31, 2007, there were unrealized losses of approximately \$43 million on our swap agreements.

Liquidity and Capital Resources

Continuing Operations

Our primary source of funds consists of repurchase agreements, relative to our Agency MBS portfolio, which totaled \$4.2 billion at December 31, 2007. As collateral for these repurchase agreements, we have pledged approximately \$4.48 billion in Agency MBS. Our other significant source of funds for the year ended December 31, 2007 consisted of payments of principal from our Agency MBS portfolio in the amount of \$1.2 billion.

Relative to our Agency MBS portfolio at December 31, 2007, all of our repurchase agreements were fixed-rate term repurchase agreements with original maturities ranging from 21 days to 24 months. At December 31, 2007, we had borrowed funds under repurchase agreements with 13 different financial institutions. As the repurchase agreements mature, we enter into new repurchase agreements to take their place. Because we borrow money based on the fair value of our MBS and because increases in short-term interest rates can negatively impact the valuation of MBS, our borrowing ability could be reduced and lenders may initiate margin calls in the event short-term interest rates increase or the value of our MBS declines for other reasons. We had adequate cash flow, liquid assets and unpledged collateral with which to meet our margin requirements during the year ended December 31, 2007.

In the future, we expect that our primary sources of funds will continue to consist of borrowed funds under repurchase agreement transactions and of monthly payments of principal and interest on our MBS portfolios. Our liquid assets generally consist of unpledged MBS, cash and cash equivalents.

On February 1 and 7, 2007, we issued an aggregate of 1.15 million shares of Series B Preferred Stock (as more fully described in Note 7 to the consolidated financial statements) and received net proceeds of approximately \$27 million. We used the proceeds from this offering to acquire mortgage-related assets consistent with our investment policy.

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On June 29, 2007, we entered into a Controlled Equity Offering Sales Agreement, or the Sales Agreement, with Cantor Fitzgerald & Co., or Cantor, to reinstate and modify a controlled equity offering program, or the Equity Program, under which Cantor will act as sales agent. Under the Equity Program, we may sell, from time to time in our sole discretion, an aggregate of up to 10 million shares of common stock, 1.225 million shares of Series A Preferred Stock and 2.0 million shares of Series B Preferred Stock.

We initially instituted the Equity Program with Cantor in December 2002. In 2005, we amended the Equity Program with Cantor to allow us to sell an additional amount of common stock and up to 2 million shares of Series A Preferred Stock. In June 2007, we entered into the Sales Agreement in order to (i) reduce the commission rate payable to Cantor on any sales of preferred stock and common stock from a rate of up to 3% to a rate of between 2.0% and 2.5%; and (ii) permit us to sell Series B Preferred Stock through the Equity Program. Sales of preferred stock and common stock made under the Equity Program will be made on the New York Stock Exchange or on any other existing trading market by means of ordinary brokers' transactions at market prices and through privately negotiated transactions. From June 29, 2007 through December 31, 2007, we sold 56 thousand shares of our Series B Preferred Stock under the Equity Program, which provided net proceeds to us of approximately \$1.38 million. The sales agent received an aggregate of approximately \$28 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share. From June 29, 2007 through December 31, 2007, we sold 1,115,100 shares of our common stock under the Equity Program, which provided net proceeds to us of approximately \$9.1 million. The sales agent received an aggregate of approximately \$214 thousand, which represents an average commission of approximately 2.3% on the gross sales price per share.

During the year ended December 31, 2007, we raised approximately \$1.3 million under our Dividend Reinvestment and Stock Purchase Plan.

In December 2007, we issued 10.35 million shares of common stock and received net proceeds of approximately \$65.5 million, net of underwriting commissions and offering expenses.

At December 31, 2007, our authorized capital included 20 million shares of \$0.01 par value preferred stock. During the year ended December 31, 2007, we did not issue any shares of Series A Preferred Stock.

Discontinued Operations

Belvedere Trust, which is reported as a discontinued operation, has three claims against it totaling approximately \$8 million, which have been contested, related to repurchase agreement transactions. Anworth is neither a co-party to nor a guarantor of Belvedere Trust's repurchase agreements or any claims against Belvedere Trust.

According to the principles related to extinguishment of liabilities and financial statement consolidation, Belvedere Trust's assets and claims and liabilities are included in Anworth's consolidated financial statements for the fiscal year ended December 31, 2007 with the effect of creating a charge against consolidated earnings in the amount of the claims. Anworth is neither a co-party to nor a guarantor of Belvedere Trust's repurchase agreements or any claims against Belvedere Trust. The dissolution of Belvedere Trust, which is expected during 2008, is expected to result in a corresponding equal increase in Anworth's consolidated earnings during the quarter of dissolution, although no assurances can be provided in with respect to the timing of the dissolution.

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The following table represents our contractual obligations at December 31, 2007 (in thousands):

	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Repurchase agreements (Anworth(1))	\$ 4,227,100	\$ 4,107,100	\$ 120,000	\$	\$
Junior subordinated notes(2)	37,380				37,380
Lease commitment (Anworth)	1,350	285	596	469	
Lease commitment (Belvedere Trust)	37	37			
Total(3):	\$ 4,265,867	\$ 4,107,422	\$ 120,596	\$ 469	\$ 37,380

(1) These represent amounts due by maturity.

(2) These represent amounts due by contractual maturity. However, we do have the option to redeem these after March 30, 2010 and April 30, 2010 as more fully described in Note 4 to the accompanying consolidated financial statements.

(3) This does not include annual compensation agreements and incentive compensation agreements, which are more fully described in Note 9 to the accompanying consolidated financial statements.

Stockholders Equity

We use available-for-sale treatment for our Agency MBS and Non-Agency MBS, which are carried on our balance sheet at fair value rather than historical cost. Based upon these treatments, our total equity base at December 31, 2007 was \$401.4 million. Common stockholders' equity was approximately \$352.5 million, or \$6.15 book value per share.

Under our available-for-sale accounting treatment, unrealized fluctuations in fair values of assets are assessed to determine whether they are other-than-temporary. To the extent we determine that these unrealized fluctuations are not other-than-temporary, they do not impact GAAP income or taxable income but rather are reflected on the balance sheet by changing the carrying value of the assets and reflecting the change in stockholders' equity under Accumulated other comprehensive income, unrealized gain (loss) on available-for-sale securities.

As a result of this mark-to-market accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used historical amortized cost accounting on all of our assets. As a result, comparisons with some companies that use historical cost accounting for all of their balance sheet may not be meaningful.

Unrealized changes in the fair value of MBS have one significant and direct effect on our potential earnings and dividends: positive mark-to-market changes will increase our equity base and allow us to increase our borrowing capacity, while negative changes will tend to reduce borrowing capacity under our capital investment policy. A very large negative change in the net market value of our MBS might reduce our liquidity, requiring us to sell assets with the likely result of realized losses upon sale. Accumulative other comprehensive income, unrealized gain on available-for-sale Agency MBS was \$14.3 million, or 0.31% of the amortized cost of our Agency MBS, at December 31, 2007. This, along with Accumulative other comprehensive loss, derivatives, of \$43.4 million, and Accumulative other comprehensive loss, Non-Agency MBS, of \$7.0 million, constitute the total Accumulative other comprehensive loss of \$36.1 million.

Critical Accounting Policies

Management has the obligation to ensure that its policies and methodologies are in accordance with GAAP. Management has reviewed and evaluated its critical accounting policies and believes them to be appropriate.

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The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements. In preparing these consolidated financial statements, management has made its best estimates and judgments of certain amounts included in the consolidated financial statements, giving due consideration to materiality. We do not believe that there is a great likelihood that materially different amounts would be reported related to accounting policies described below. Nevertheless, application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ materially from these estimates.

Our accounting policies for continuing operations are described in Note 1 and the accounting policies for discontinued operations are described in Note 16, respectively, to the accompanying consolidated financial statements. Management believes the more significant of our accounting policies for continuing operations are the following:

Revenue Recognition

The most significant source of our revenue is derived from our investments in mortgage-related assets. We reflect income using the effective yield method which, through amortization of premiums and accretion of discounts at an effective yield, recognizes periodic income over the estimated life of the investment on a constant yield basis, as adjusted for actual prepayment activity. Management believes our revenue recognition policies are appropriate to reflect the substance of the underlying transactions.

Interest income on our mortgage-related assets is accrued based on the actual coupon rate and the outstanding principal amounts of the underlying mortgages. Premiums and discounts are amortized or accreted into interest income over the expected lives of the securities using the effective interest yield method, adjusted for the effects of actual prepayments and estimated prepayments based on the Statement of Financial Accounting Standards, or SFAS, No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, an amendment of FASB Statements No. 13, 60, and 65 and a rescission of FASB Statement No. 17. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, street consensus prepayment speeds and current market conditions. If our estimate of prepayments is incorrect, as compared to the aforementioned references, we may be required to make an adjustment to the amortization or accretion of premiums and discounts that would have an impact on future income.

Valuation and Classification of Investment Securities

We carry our investment securities on the balance sheet at fair value. The fair values of our MBS are generally based on market prices provided by certain dealers who make markets in such securities. The fair values of other marketable securities are obtained from the last reported sale of such securities on its principal exchange or, if no representative sale is reported, the mean between the closing bid and ask prices. If, in the opinion of management, one or more securities prices reported to us are not reliable or unavailable, management estimates the fair value based on characteristics of the security it receives from the issuer and available market information. The fair values reported reflect estimates and may not necessarily be indicative of the amounts we could realize in a current market exchange. We review various factors (i.e., expected cash flows, changes in interest rates, credit protection, etc.) in determining whether and to what extent an other-than-temporary impairment exists. To the extent that unrealized losses on our Agency MBS and Non-Agency MBS are attributable to changes in interest rates and not credit quality, and we have the ability and intent to hold these investments until a recovery of fair value up to (or beyond) its cost, which may be maturity, we do not consider these investments to be other-than-temporarily impaired. Losses on securities classified as available-for-sale, which are determined by management to be other-than-temporary in nature, are reclassified from Accumulated other comprehensive income to current-period income.

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Accounting for Derivatives and Hedging Activities

In accordance with FASB No. 133, *Accounting for Derivative Instruments and Hedging Activities*, or FASB 133, as amended by FASB No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, or FASB 138, a derivative that is designated as a hedge is recognized as an asset/liability and measured at estimated fair value. In order for our interest rate swap agreements to qualify for hedge accounting, upon entering into the swap agreement, we must anticipate that the hedge will be highly effective, as defined by FASB 133.

On the date we enter into a derivative contract, we designate the derivative as a hedge of the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a cash flow hedge). Changes in the fair value of a derivative that are highly effective and that are designated and qualify as a cash flow hedge, to the extent that the hedge is effective, are recorded in Other comprehensive income and reclassified to income when the forecasted transaction affects income (e.g., when periodic settlement interest payments are due on repurchase agreements). The swap agreements are carried on our Consolidated Balance Sheets at their fair value based on values obtained from major financial institutions. Hedge ineffectiveness, if any, is recorded in current-period income.

We formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. If it is determined that a derivative is not (or has ceased to be) highly effective as a hedge, we discontinue hedge accounting.

When we discontinue hedge accounting, the gain or loss on the derivative remains in Accumulated other comprehensive income and is reclassified into income when the forecasted transaction affects income. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, we will carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value in current-period income.

For purposes of the cash flow statement, cash flows from derivative instruments are classified with the cash flows from the hedged item.

Income Taxes

Other than BT Finance, as noted below, our financial results do not reflect provisions for current or deferred income taxes. Management believes that we have and intend to continue to operate in a manner that will continue to allow us to be taxed as a REIT and, as a result, does not expect to pay substantial corporate level taxes. Many of these requirements, however, are highly technical and complex. If we were to fail to meet these requirements, we would be subject to federal income tax.

BT Finance, our indirect wholly-owned subsidiary, is a taxable REIT subsidiary and may be liable for corporate income tax expenses. BT Finance, as a subsidiary of Belvedere Trust, is reported within Discontinued operations and is also in the process of being liquidated.

Subsequent Events

Since December 31, 2007, we have entered into twelve additional swap agreements with an aggregate notional amount of \$740 million for terms of up to five years. We utilize swap agreements to manage interest rate risk. In accordance with these swap agreements, we pay a fixed rate of interest during the term of the swap agreements and receive a payment that varies with the three-month LIBOR rate.

On January 25, 2008, we declared a Series A Preferred Stock dividend of \$0.539063 per share and a Series B Preferred Stock dividend of \$0.390625 per share, each of which is payable on April 15, 2008 to our holders of record of Series A Preferred Stock and Series B Preferred Stock, respectively, as of the close of business on March 31, 2008.

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On January 30, 2008, we issued an aggregate of 16.445 million shares of common stock and received net proceeds of approximately \$136.5 million (net of underwriting fees, commissions and other costs). We used all of the net proceeds from this offering to acquire Agency MBS.

From January 2, 2008 through March 7, 2008, we sold 1.65 million shares of common stock under the Program with Cantor which provided net proceeds to us of approximately \$15.4 million. The sales agent received an aggregate of approximately \$394 thousand, which represents an average commission of approximately 2.5 % on the gross sales price per share.

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Item 7A. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

We seek to manage the interest rate, market value, liquidity, prepayment and credit risks inherent in all financial institutions in a prudent manner designed to insure our longevity while, at the same time, seeking to provide an opportunity for stockholders to realize attractive total rates of return through ownership of our common stock. While we do not seek to avoid risk completely, we do seek, to the best of our ability, to assume risk that can be quantified from historical experience, to actively manage that risk, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

Interest Rate Risk

We primarily invest in adjustable-rate, hybrid and fixed-rate mortgage-related assets. Hybrid mortgages are ARMs that have a fixed interest rate for an initial period of time (typically three years or greater) and then convert to an adjustable-rate for the remaining loan term. Our debt obligations are generally repurchase agreements of limited duration that are periodically refinanced at current market rates.

ARM-related assets are typically subject to periodic and lifetime interest rate caps that limit the amount an ARM-related asset's interest rate can change during any given period. ARM securities are also typically subject to a minimum interest rate payable. Our borrowings are not subject to similar restrictions. Hence, in a period of increasing interest rates, interest rates on our borrowings could increase without limitation, while the interest rates on our mortgage-related assets could be limited. This problem would be magnified to the extent we acquire mortgage-related assets that are not fully indexed. Further, some ARM-related assets may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would negatively impact our liquidity, net income and our ability to make distributions to stockholders.

We fund the purchase of a substantial portion of our ARM-related assets with borrowings that have interest rates based on indices and repricing terms similar to, but of somewhat shorter maturities than, the interest rate indices and repricing terms of our mortgage assets. Thus, we anticipate that in most cases the interest rate indices and repricing terms of our mortgage assets and our funding sources will not be identical, thereby creating an interest rate mismatch between assets and liabilities. During periods of changing interest rates, such interest rate mismatches could negatively impact our net interest income, dividend yield and the market price of our common stock.

Most of our adjustable-rate assets are based on the one-year constant maturity treasury rate and the one-year LIBOR rate and our debt obligations are generally based on LIBOR. These indices generally move in the same direction, but there can be no assurance that this will continue to occur.

Our ARM-related assets and borrowings reset at various different dates for the specific asset or obligation. In general, the repricing of our debt obligations occurs more quickly than on our assets. Therefore, on average, our cost of funds may rise or fall more quickly than does our earnings rate on the assets.

Further, our net income may vary somewhat as the spread between one-month interest rates and six- and twelve-month interest rates varies.

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At December 31, 2007, our Agency MBS and Non-Agency MBS and related borrowings will prospectively reprice based on the following time frames (dollar amounts in thousands):

	Investments(1)		Borrowings	
	Amount	Percentage of Total Investments	Amount	Percentage of Total Borrowings
Investment Type/Rate Reset Dates:				
Fixed-rate investments	\$ 819,407	17.4%	\$	
Adjustable-Rate Investments/Obligations:				
Less than 3 months	260,948	5.5	4,032,100	95.4%
Greater than 3 months and less than 1 year	709,315	15.1	75,000	1.8
Greater than 1 year and less than 2 years	214,649	4.6	120,000	2.8
Greater than 2 years and less than 3 years	62,893	1.3		
Greater than 3 years and less than 5 years	2,638,049	56.1		
Total:	\$ 4,705,261	100.0%	\$ 4,227,100	100.0%

(1) Based on when they contractually reprice and do not consider the effect of any prepayments.

At December 31, 2006, our Agency MBS and Non-Agency MBS and related borrowings will prospectively reprice based on the following time frames (dollar amounts in thousands):

	Investments(1)		Borrowings	
	Amount	Percentage of Total Investments	Amount	Percentage of Total Borrowings
Investment Type/Rate Reset Dates:				
Fixed-rate investments	\$ 750,479	15.7%	\$	
Adjustable-Rate Investments/Obligations:				
Less than 3 months	368,428	7.7	2,560,750	59.1%
Greater than 3 months and less than 1 year	962,617	20.1	1,769,171	40.9
Greater than 1 year and less than 2 years	681,347	14.2		
Greater than 2 years and less than 3 years	502,303	10.5		
Greater than 3 years and less than 5 years	1,520,756	31.8		
Total:	\$ 4,785,930	100.0%	\$ 4,329,921	100.0%

(1) Based on when they contractually reprice and do not consider the effect of any prepayments.

Market Value Risk

All of our MBS are classified as available-for-sale assets. As such, they are reflected at fair value (i.e., market value) with the periodic adjustment to fair value reflected as part of Accumulated other comprehensive income that is included in the equity section of our balance sheet. The market value of our assets can fluctuate due to changes in interest rates and other factors.

Liquidity Risk

Our primary liquidity risk arises from financing long-maturity MBS with short-term debt. The interest rates on our borrowings generally adjust more frequently than the interest rates on our adjustable-rate MBS. For example, at December 31, 2007, our Agency MBS and Non-Agency

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adjustable-rate MBS had a weighted average term to next rate adjustment of approximately 36 months while our borrowings had a weighted average term to next rate adjustment of 49 days. After adjusting for interest rate swap transactions, the weighted average term to

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next rate adjustment was 418 days. Accordingly, in a period of rising interest rates, our borrowing costs will usually increase faster than our interest earnings from MBS. As a result, we could experience a decrease in net income or a net loss during these periods (as what occurred in 2006). Our assets that are pledged to secure short-term borrowings are high-quality liquid assets. As a result, we have not had difficulty rolling over our short-term borrowings as they mature. There can be no assurance that we will always be able to roll over our short-term debt.

At December 31, 2007, we had unrestricted cash of \$12.4 million and \$226.3 million in unpledged Agency MBS and Non-Agency MBS available to meet margin calls on short-term borrowings that could be caused by asset value declines or changes in lender collateralization requirements.

Prepayment Risk

Prepayments are the full or partial repayment of principal prior to the original term to maturity of a mortgage loan and typically occur due to refinancing of mortgage loans. Prepayment rates on mortgage-related securities and mortgage loans vary from time to time and may cause changes in the amount of our net interest income. Prepayments of ARM loans usually can be expected to increase when mortgage interest rates fall below the then-current interest rates on such loans and decrease when mortgage interest rates exceed the then-current interest rate on such loans, although such effects are not entirely predictable. Prepayment rates may also be affected by the conditions in the housing and financial markets, general economic conditions and the relative interest rates on fixed-rate loans and ARM loans underlying MBS. The purchase prices of MBS are generally based upon assumptions regarding the expected amounts and rates of prepayments. Where slow prepayment assumptions are made, we may pay a premium for MBS. To the extent such assumptions differ from the actual amounts of prepayments, we could experience reduced earnings or losses. The total prepayment of any MBS purchased at a premium by us would result in the immediate write-off of any remaining capitalized premium amount and a reduction of our net interest income by such amount. Finally, in the event that we are unable to acquire new MBS to replace the prepaid MBS, our financial condition, cash flows and results of operations could be harmed.

We often purchase mortgage-related assets that have a higher interest rate than the market interest rate at the time. In exchange for this higher interest rate, we must pay a premium over par value to acquire these assets. In accordance with accounting rules, we amortize this premium over the term of the mortgage-backed security. As we receive repayments of mortgage principal, we amortize the premium balances as a reduction to our income. If the mortgage loans underlying a mortgage-backed security were prepaid at a faster rate than we anticipate, we would amortize the premium at a faster rate. This would reduce our income.

Tabular Presentation

Anworth's MBS

The information presented in the table below projects the impact of sudden changes in interest rates on Anworth's annual Projected Net Interest Income and Projected Portfolio Value as more fully discussed below, based on investments in place at December 31, 2007, and includes all of our interest rate-sensitive assets, liabilities and hedges, such as interest rate swap agreements.

Changes in Projected Net Interest Income equals the change that would occur in the calculated Projected Net Interest Income for the next twelve months relative to the 0% change scenario if interest rates were to instantaneously parallel shift to and remain at the stated level for the next twelve months.

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Changes in Projected Portfolio Value equals the change in value of our assets that we carry at fair value rather than at historical amortized cost and any change in the value of any derivative instruments or hedges, such as interest rate swap agreements. We acquire interest rate-sensitive assets and fund them with interest rate-sensitive liabilities. We generally plan to retain such assets and the associated interest rate risk to maturity.

Percentage Change in		
Change in Interest Rates	Projected Net Interest Income	Percentage Change In Projected Portfolio Value
2.0%	58%	0.5%
1.0%	18%	0.2%
0%		
1.0%	25%	1.8%
2.0%	56%	4.3%

When interest rates are shocked, prepayment assumptions are adjusted based on management's best estimate of the effects of changes in interest rates on prepayment speeds. For example, under current market conditions, a 100 basis point decline in interest rates is estimated to result in a 122% increase in the prepayment rate of our Agency MBS and Non-Agency portfolios. The base interest rate scenario assumes interest rates at December 31, 2007. Actual results could differ significantly from those estimated in the table. The above table includes the effect of interest rate swap agreements. At December 31, 2007, the aggregate notional amount of the interest rate swap agreements was \$2.04 billion and the weighted average maturity was 2.4 years.

The information presented in the table below projects the impact of sudden changes in interest rates on Anworth's annual Projected Net Income and Projected Portfolio Value compared to the base case used in the table above and excludes the effect of the interest rate swap agreements.

Percentage Change in		
Change in Interest Rates	Projected Net Interest Income	Percentage Change In Projected Portfolio Value
2.0%	34%	1.3%
1.0%	36%	1.1%
0%		
1.0%	45%	2.7%
2.0%	112%	6.2%

General

Many assumptions are made to present the information in the above tables and, as such, there can be no assurance that assumed events will occur, or that other events will not occur, that would affect the outcomes; therefore, the above tables and all related disclosures constitute forward-looking statements. The analyses presented utilize assumptions and estimates based on management's judgment and experience. Furthermore, future sales, acquisitions and restructuring could materially change the interest rate risk profile for us. The tables quantify the potential changes in net income and net asset value should interest rates immediately change (are "shocked"). The results of interest rate shocks of plus and minus 100 and 200 basis points are presented. The cash flows associated with the portfolio of mortgage-related assets for each rate shock are calculated based on a variety of assumptions including prepayment speeds, time until coupon reset, yield on future acquisitions, slope of the yield curve and size of the portfolio. Assumptions made on the interest rate-sensitive liabilities, which are repurchase agreements, include anticipated interest rates (no negative rates are utilized), collateral requirements as a percent of the repurchase agreement and amount of borrowing. Assumptions made in calculating the impact on net asset value of interest rate shocks include interest rates, prepayment rates and the yield spread of mortgage-related assets relative to prevailing interest rates.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

The financial statements and related financial information required to be filed hereunder are indexed under Item 15 of this Annual Report on Form 10-K and are incorporated herein by reference.

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Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

Item 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls

We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), designed to ensure that information required to be disclosed by us in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported on a timely basis.

Our management, with the participation of our Principal Executive Officer and Principal Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. Based on such evaluation, our Principal Executive Officer and Principal Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are effective.

Management Report on Internal Control Over Financial Reporting

The management of Anworth is responsible for establishing and maintaining adequate internal control over financial reporting. Anworth's internal control system was designed to provide reasonable assurance to the company's management and board of directors regarding the preparation and fair presentation of prepared financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Our management assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2007. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control - Integrated Framework*. Based on our assessment, we believe that, as of December 31, 2007, Anworth's internal control over financial reporting is effective based on those criteria.

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Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders

Anworth Mortgage Asset Corporation

Santa Monica, California

We have audited Anworth Mortgage Asset Corporations (Anworths) internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Anworths management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Anworth maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Anworth as of December 31, 2007 and 2006, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007 and our report dated March 12, 2008 expressed an unqualified opinion thereon.

BDO Seidman, LLP

Los Angeles, California

March 12, 2008

Item 9B. OTHER INFORMATION

None.

Table of Contents**PART III****Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this Item is incorporated herein by reference from the information under the captions entitled Election of Directors Information Regarding Nominees for Director, Executive Officers and Section 16(a) Beneficial Ownership Reporting Compliance in our definitive proxy statement to be filed with the SEC no later than April 29, 2008.

Item 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference from the information under the caption entitled Executive Compensation in our definitive proxy statement to be filed with the SEC no later than April 29, 2008.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Certain of the information required by this Item is incorporated by reference from the information under the caption entitled Security Ownership of Certain Beneficial Owners and Management in our definitive proxy statement to be filed with the SEC no later than April 29, 2008.

Equity Compensation Plan Information

The following table provides information as of December 31, 2007 with respect to our common shares issuable under our 2004 Equity Compensation Plan:

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders(1)	1,360,930	\$ 12.123	1,212,402
Equity compensation plans not approved by security holders(2)	N/A	N/A	N/A
Total	1,360,930	\$ 12.123	1,212,402

- (1) In May 2004, our stockholders adopted the Anworth Mortgage Asset Corporation 2004 Equity Compensation Plan, or the Plan, which amended and restated our 1997 Stock Option and Awards Plan. The Plan authorized the board of directors or a committee of our board to grant options to purchase of up to 3,500,000 of the outstanding shares of our common stock. The Plan does not provide for automatic annual increases in the aggregate share reserve or the number of shares remaining available for grant. On November 7, 2005, we filed a registration statement on Form S-8 to register an aggregate of 3,500,000 shares of our common stock, which may be issued pursuant to our 2004 Equity Compensation Plan.
- (2) The Company has not authorized the issuance of its equity securities under any plan not approved by security holders.

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Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated by reference from the information under the caption entitled Certain Transactions and Relationships in our definitive proxy statement to be filed with the SEC no later than April 29, 2008.

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated by reference from the information under the caption entitled Principal Accountant Fees and Services in our definitive proxy statement to be filed with the SEC no later than April 29, 2008.

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PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report:

(1) The following financial statements of the Company are included in Part II, Item 8 of this Annual Report on Form 10-K:

Report of Independent Registered Public Accounting Firm, BDO Seidman, LLP;
Consolidated Balance Sheets as of December 31, 2007 and December 31, 2006;
Consolidated Statements of Income: Years Ended December 31, 2007, December 31, 2006 and December 31, 2005;
Consolidated Statements of Stockholders' Equity: Years Ended December 31, 2007, December 31, 2006 and December 31, 2005;
Consolidated Statements of Cash Flows: Years Ended December 31, 2007, December 31, 2006 and December 31, 2005; and
Notes to Consolidated Financial Statements.

(2) Schedules to financial statements:

All financial statement schedules have been omitted because they are either inapplicable or the information required is provided in the Company's Consolidated Financial Statements and Notes thereto, included in Part II, Item 8 of this Annual Report on Form 10-K.

(3) The exhibits listed on the accompanying Exhibit Index are filed as part of this Annual Report on Form 10-K.

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SIGNATURES

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

DATED: March 12, 2008

ANWORTH MORTGAGE ASSET CORPORATION

/s/ JOSEPH LLOYD McADAMS
Joseph Lloyd McAdams

Chairman of the Board, President and

Chief Executive Officer

(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ JOSEPH LLOYD McADAMS Joseph Lloyd McAdams	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)	March 12, 2008
/s/ THAD M. BROWN Thad M. Brown	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 12, 2008
/s/ JOSEPH E. McADAMS Joseph E. McAdams	Executive Vice President, Chief Investment Officer and Director	March 12, 2008
/s/ LEE A. AULT, III Lee A. Ault, III	Director	March 12, 2008
/s/ CHARLES H. BLACK Charles H. Black	Director	March 12, 2008
/s/ JOE E. DAVIS Joe E. Davis	Director	March 12, 2008
/s/ ROBERT C. DAVIS Robert C. Davis	Director	March 12, 2008

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A NWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

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<u>Consolidated Statements of Income (Loss) for the Years Ended December 31, 2007, 2006 and 2005</u>	F-4
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Anworth Mortgage Asset Corporation

Santa Monica, California

We have audited the accompanying consolidated balance sheets of Anworth Mortgage Asset Corporation (Anworth) as of December 31, 2007 and 2006 and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Anworth at December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Anworth's internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 12, 2008 expressed an unqualified opinion thereon.

As discussed in Note 12 to the financial statements, effective January 1, 2006, the Company changed its method of quantifying misstatements of prior year financial statements. The Company adopted the dual method, as required by SEC Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements."

BDO Seidman, LLP

Los Angeles, California

March 12, 2008

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in thousands, except per share amounts)

	December 31, 2007	December 31, 2006
ASSETS		
Agency MBS:		
Agency MBS pledged to counterparties at fair value	\$ 4,478,983	\$ 4,449,129
Agency MBS at fair value	183,564	229,778
	4,662,547	4,678,907
Non-Agency MBS:		
Non-Agency MBS pledged to counterparties at fair value		104,508
Non-Agency MBS at fair value	42,714	2,515
	42,714	107,023
Cash and cash equivalents	12,440	34
Interest and dividends receivable	25,618	27,129
Derivative instruments at fair value	1,791	11,757
Prepaid expenses and other	52,371	3,750
Cash and cash equivalents of discontinued operations		141
Assets of discontinued operations	38	1,858,648
	\$ 4,797,519	\$ 6,687,389
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accrued interest payable	\$ 40,892	\$ 60,619
Repurchase agreements (Anworth)	4,227,100	4,329,921
Junior subordinated notes	37,380	37,380
Derivative instruments at fair value	45,193	6,877
Dividends payable on Series A Preferred Stock	1,011	2,022
Dividends payable on Series B Preferred Stock	471	
Dividends payable on common stock	6,765	912
Accrued expenses and other	1,317	2,596
Liabilities of discontinued operations	7,834	1,756,060
	\$ 4,367,963	\$ 6,196,387
Series B Cumulative Convertible Preferred Stock: par value \$0.01 per share; liquidating preference \$25.00 per share (\$30,150 and \$0, respectively); 1,206 and 0 shares issued and outstanding at December 31, 2007 and 2006, respectively	\$ 28,108	\$
Stockholders' equity:		
Series A Cumulative Preferred Stock: par value \$0.01 per share; liquidating preference \$25.00 per share (\$46,888 and \$46,888, respectively); 1,876 and 1,876 shares issued and outstanding, at December 31, 2007 and 2006, respectively	\$ 45,397	\$ 45,397
Common Stock: par value \$0.01 per share; authorized 100,000 shares, 57,289 and 45,609 issued and outstanding, at December 31, 2007 and 2006, respectively	573	456
Additional paid-in capital	601,462	525,607
Accumulated other comprehensive loss consisting of unrealized losses and gains	(36,129)	(45,435)

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Accumulated deficit	(209,855)	(35,023)
	\$ 401,448	\$ 491,002
	\$ 4,797,519	\$ 6,687,389

See accompanying notes to consolidated financial statements.

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Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME (LOSS)****(in thousands, except per share amounts)**

	For the Year Ended December 31,		
	2007	2006	2005
Interest income net of amortization of premium and discount:			
Interest on Agency MBS	\$ 243,853	\$ 205,755	\$ 159,248
Interest on Non-Agency MBS	4,978	532	
	248,831	206,287	159,248
Interest expense:			
Interest expense on repurchase agreements (Anworth)	221,697	198,953	129,101
Interest expense on junior subordinated notes	3,187	3,084	1,998
	224,884	202,037	131,099
Net interest income	23,947	4,250	28,149
Loss on sale of Agency MBS and Non-Agency MBS	(23,442)	(10,207)	
Net loss on derivative instruments	(147)		
Expenses:			
Compensation and benefits	(2,443)	(2,304)	(2,261)
Compensation-amortization of restricted stock	97	(397)	(40)
Incentive compensation			(708)
Other expenses	(3,190)	(2,783)	(2,865)
Total expenses	(5,536)	(5,484)	(5,874)
(Loss) income from continuing operations	(5,178)	(11,441)	22,275
(Loss) income from discontinued operations	(151,288)	(2,763)	6,610
Net (loss) income	\$ (156,466)	\$ (14,204)	\$ 28,885
Dividend on Series A Cumulative Preferred Stock(1)	\$ (3,033)	\$ (4,044)	\$ (3,901)
Dividend on Series B Cumulative Convertible Preferred Stock	\$ (1,716)	\$	\$
Net (loss) income available to common stockholders	\$ (161,215)	\$ (18,248)	\$ 24,984
Basic (loss) earnings per common share:			
Continuing operations	\$ (0.21)	\$ (0.34)	\$ 0.39
Discontinued operations	\$ (3.26)	\$ (0.06)	\$ 0.14
Total basic (loss) earnings per common share	\$ (3.47)	\$ (0.40)	\$ 0.53
Diluted (loss) earnings per common share:			
Continuing operations	\$ (0.21)	\$ (0.34)	\$ 0.39
Discontinued operations	\$ (3.26)	\$ (0.06)	\$ 0.14

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Total basic (loss) earnings per common share	\$ (3.47)	\$ (0.40)	\$ 0.53
Basic weighted average number of shares outstanding	46,483	45,430	47,103
Diluted weighted average number of shares outstanding	46,483	45,430	47,128

(1) As restated in Note 12

See accompanying notes to consolidated financial statements.

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Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY****Years ended December 31, 2007, 2006 and 2005****(in thousands, except per share amounts)**

	Series A Preferred Stock Shares	Common Stock Shares	Series A Preferred Stock Value	Common Stock Par Value	Additional Paid-In Capital	Accum. Other Income (Loss) Agency MBS	Accum. Other Income (Loss) Non-Agency MBS	Accum. Other Income (Loss) Derivatives	Accum. Other Income (Loss) Other MBS	Accum. (Deficit)	Treasury Stock at Cost	Comp. Income (Loss)	Total
Balance, December 31, 2004	1,101	46,497	\$ 26,435	\$ 465	\$ 533,725	\$ (45,491)	\$	\$ 4,122	\$ (1,229)	\$ (10,991)	\$		\$ 507,036
Issuance of Series A Preferred Stock	775		18,962										18,962
Issuance of common stock		2,282		23	20,956								20,979
Issuance of restricted stock		201		2	(2)								
Purchases of treasury stock											(29,841)		(29,841)
Retired treasury stock		(3,583)		(36)	(29,805)						29,841		
Other comprehensive income (loss), fair value adjustments						(39,936)		8,827	(1,913)			(33,022)	(33,022)
Net income										28,885		28,885	28,885
Total comprehensive income (loss)												\$ (4,137)	
Amortization of restricted stock					119								119
Dividend declared \$2.156252 per Series A preferred share										(3,901)			(3,901)
Dividends declared \$0.55 per common share										(26,118)			(26,118)
Balance, December 31, 2005	1,876	45,397	\$ 45,397	\$ 454	\$ 524,993	\$ (85,427)	\$	\$ 12,949	\$ (3,142)	\$ (12,125)	\$		\$ 483,099
Issuance of common stock		45			359								359
Issuance of restricted stock		205		2	64								66
Purchases of treasury stock											(285)		(285)
Retired treasury stock		(38)			(285)						285		0
						34,908		(8,067)	3,344			30,185	30,185

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[illegible]

See accompanying notes to consolidated financial statements.

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	For the Year Ended December 31,		
	2007	2006	2005
Operating Activities:			
(Loss) income from continuing operations	\$ (5,178)	\$ (11,441)	\$ 22,275
Adjustments to reconcile net (loss) income to net cash provided by			
(used in) operating activities:			
Amortization of premium and discounts (Agency MBS)	21,092	27,631	40,846
Loss on sale of Agency MBS and Non-Agency MBS	23,442	10,207	
Loss on derivative instruments	147		
Amortization of restricted stock	(18)	476	119
Changes in assets and liabilities:			
(Decrease) increase in interest receivable	1,511	(5,284)	(2,767)
Decrease (increase) in prepaid expenses and other	(48,745)	(1,378)	9
(Decrease) increase in accrued interest payable	(19,727)	26,924	15,228
(Decrease) increase in accrued expenses and other	(1,279)	(8,423)	8,717
Net cash provided by (used in) operating activities of discontinued operations	(29,864)	13,994	31,185
Net cash provided by operating activities	\$ (58,619)	\$ 52,706	\$ 115,612
Investing Activities:			
Available-for-sale Agency MBS:			
Purchases	\$ (2,047,388)	\$ (1,988,185)	\$ (1,770,019)
Principal payments	1,235,399	1,437,972	1,753,094
Proceeds from sales	858,019	393,057	
Available-for-sale Non-Agency MBS:			
Purchases	(20,000)	(108,775)	
Principal payments	21,828	1,752	
Proceeds from sales	46,047		
Net cash provided by investing activities of discontinued operations	494,702	731,950	74,835
Net cash provided by investing activities	\$ 588,607	\$ 467,771	\$ 57,910
Financing Activities:			
Borrowings from repurchase agreements	\$ 28,320,977	\$ 21,998,859	\$ 16,060,065
Repayments on repurchase agreements	(28,423,798)	(21,768,348)	(16,133,585)
Proceeds from junior subordinated notes			35,160
Proceeds from common stock issued, net	75,990	426	20,979
Proceeds from Series A Preferred Stock issued, net			18,962
Proceeds from Series B Preferred Stock issued, net	28,108		
Series A Preferred stock dividends paid	(4,044)	(4,044)	(3,260)
Series B Preferred stock dividends paid	(1,245)		
Common stock dividends paid	(7,764)	(3,635)	(37,764)
Treasury stock purchased		(285)	(29,841)
Net cash used in financing activities of discontinued operations	(505,947)	(751,523)	(99,032)
Net cash used in financing activities	\$ (517,723)	\$ (528,550)	\$ (168,316)

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Net increase (decrease) in cash and cash equivalents	\$	12,265	\$	(8,073)	\$	5,206
Cash and cash equivalents at beginning of period		34		27		1,983
Add: net decrease (increase) in cash of discontinued operations		141		8,080		(7,162)
Cash and cash equivalents at end of period	\$	12,440	\$	34	\$	27
Supplemental Disclosure of Cash Flow Information:						
Cash paid for interest	\$	244,611	\$	175,088	\$	115,580
Supplemental Disclosure of Investing and Financing Activities:						
Retirement of treasury stock	\$		\$	285	\$	29,841
Restricted stock issued	\$		\$	1,800	\$	1,550
Deconsolidation of variable interest entities	\$	1,214,452	\$		\$	

See accompanying notes to consolidated financial statements.

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Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME****(in thousands)**

	For the Year Ended December 31,		
	2007	2006	2005
Net (loss) income	\$ (156,466)	\$ (14,204)	\$ 28,885
Available-for-sale Agency MBS, fair value adjustment	50,759	24,701	(39,936)
Reclassification adjustment for losses on sales included in net loss	14,011	10,207	
Available-for-sale Non-Agency MBS, fair value adjustment	(16,434)		
Reclassification adjustment for losses on sales included in net loss	9,431		
Unrealized (losses) gains on cash flow hedges	(39,790)	(1,866)	8,045
Reclassification adjustment for losses on derivative instruments	147		
Reclassification adjustment for interest (income) expense included in net (loss) income	(8,616)	(6,201)	782
Discontinued operations BT Other MBS, fair value adjustment	(202)	5,971	(1,913)
Discontinued operations Reclassification adjustment for gains on sales included in net (loss) income		(2,627)	
	9,306	30,185	(33,022)
Comprehensive income (loss)	\$ (147,160)	\$ 15,981	\$ (4,137)

See accompanying notes to consolidated financial statements.

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Anworth Mortgage Asset Corporation, or Anworth, was incorporated in Maryland on October 20, 1997 and commenced operations on March 17, 1998. We are in the business of investing primarily in United States agency mortgage-backed securities, referred to as Agency MBS. United States agency securities are securities that are obligations guaranteed by the United States government or guaranteed by federally sponsored enterprises such as Fannie Mae, Freddie Mac or Ginnie Mae. We seek attractive long-term investment returns by investing our equity capital and borrowed funds in such securities and other mortgage-related assets.

We have elected to be taxed as a real estate investment trust, or REIT, under the Code. As a REIT, we routinely distribute substantially all of the income generated from our operations to our stockholders. As long as we retain our REIT status, we generally will not be subject to federal or state taxes on our income to the extent that we distribute our net income to our stockholders.

In November 2003, we formed Belvedere Trust Mortgage Corporation, or Belvedere Trust, to acquire mortgage loans and other mortgage-related assets. Through May 2005, Belvedere Trust securitized a substantial amount of those mortgage loans and retained a portion of the MBS while selling the balance to third parties in the secondary market. Since 2005, Belvedere Trust invested in senior and subordinated tranches from other issuers' securitizations.

Due to liquidity and credit problems surrounding the mortgage markets generally in the third quarter of 2007, Belvedere Trust received margin calls from its lenders that it was unable to meet, resulting in defaults under lines of credit. On September 5, 2007, following discussions with financial advisers retained by Belvedere Trust in connection with the issues facing the credit markets, it was determined that obtaining alternate financing for Belvedere Trust was unlikely and we concluded that a material charge for impairment with respect to all of Belvedere Trust's assets was required under generally accepted accounting principles, or GAAP. In September 2007, we developed a plan to dispose of Belvedere Trust. In December 2007, Belvedere Trust received several notices of default from its remaining counterparties which it was unable to meet and, as a result, its remaining assets were either seized or written off. Belvedere Trust, which is reported as a discontinued operation in the financial statements included in this Annual Report on Form 10-K, has three claims against it totaling approximately \$8 million, which have been contested, related to repurchase agreement transactions. Anworth is neither a co-party to nor a guarantor of Belvedere Trust's repurchase agreements or any claims against Belvedere Trust.

BASIS OF PRESENTATION AND CONSOLIDATION

The accompanying consolidated financial statements are prepared on the accrual basis of accounting in accordance with GAAP utilized in the United States of America. 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 materially differ from these estimates. Our consolidated financial statements include the accounts of all subsidiaries and consolidated variable interest entities, or VIEs. BT Management is owned 50% by Anworth, 45% by the executive officers of Belvedere Trust and 5% by Lloyd McAdams, our Chairman and Principal Executive Officer. BT Management cannot take numerous actions without our consent. We have also provided substantially all of the equity at risk for BT Management. Therefore, for these various reasons, BT Management is included in these consolidated financial statements. Significant intercompany accounts and transactions have been eliminated. In the opinion of management, all material adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included.

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Change in Basis of Presentation

For the year ended December 31, 2006, we decided to present the major components of interest income and interest expense to provide more information on our mortgage-related assets and the related liabilities. The corresponding amounts for the year ended December 31, 2005 is presented in the same manner for conformity.

In accordance with Statement of Financial Accounting Standards, or SFAS, No. 144, Impairment of Long-Lived Assets, or SFAS No. 144, we have determined that the operations and cash flows of Belvedere Trust can be identified and eliminated from the ongoing operations and that we will not have any significant continuing involvement in the operations of Belvedere Trust. Management has developed a plan to dispose of Belvedere Trust as discussed in Note 16. Accordingly, the related assets, liabilities, income and expense of Belvedere Trust are reported as a discontinued operation (see Note 16) and the information for all prior periods is presented in the same manner for conformity.

Belvedere Trust had structured securitization transactions primarily through non-qualified special purpose entities, or SPEs. This business activity involved issuing various series of MBS (in the form of pass-through certificates or bonds collateralized by residential real estate loans). The collateral specific to each series of MBS was the sole source of repayment of the debt and, therefore, Belvedere Trust's exposure to loss was limited to their net investment in the collateral. Under Financial Accounting Standards Board, or FASB, Interpretation No. 46, or FIN 46,

Consolidation of Variable Interest Entities, these interests in non-qualified SPEs were deemed to be VIEs and Belvedere Trust had been considered the primary beneficiary. These interests had been previously reported as BT Residential Loans. As many of the interests Belvedere Trust formerly owned have now been sold or seized by Belvedere Trust's repurchase agreement lenders, Belvedere Trust no longer owns sufficient interest in its securitizations, is not expected to be the entity absorbing the majority of the expected losses and, therefore, is no longer considered the primary beneficiary. At December 31, 2007, we are no longer consolidating these interests. For all prior periods, BT Residential Loans are included in Assets of discontinued operations.

As BT Management was formed to manage Belvedere Trust, and there will not be a sufficient amount of base fee paid by Belvedere Trust to BT Management to continue its operations, we have determined (in accordance with SFAS No. 144) that the operations and cash flows of BT Management can be identified and eliminated from the ongoing operations and that we will not have any significant continuing involvement in the operations of BT Management. Accordingly, the related assets, liabilities, income and expense of BT Management are reported as a discontinued operation (see Note 16) and the information for all prior periods is presented in the same manner for conformity.

The following is a summary of our significant accounting policies:

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less. The carrying amount of cash equivalents approximates their fair value.

Mortgage-Backed Securities (MBS)

Agency MBS are securities that are obligations which are guaranteed by the United States government or its sponsored enterprises such as Fannie Mae, Freddie Mac and Ginnie Mae. The payment of principal and interest on the Fannie Mae and Freddie Mac MBS are guaranteed by those respective agencies. The payment of principal and interest on the Ginnie Mae MBS are backed by the full faith and credit of the United States government.

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Relative to our investment grade Agency MBS portfolio, we have invested primarily in fixed-rate and adjustable-rate mortgage-backed pass-through certificates and hybrid adjustable-rate MBS. Hybrid adjustable-rate MBS have an initial interest rate that is fixed for a certain period, usually three to five years, and then adjust annually for the remainder of the term of the loan. We structure our investment portfolio to be diversified with a variety of prepayment characteristics, investing in mortgage-related assets with prepayment penalties, investing in certain mortgage security structures that have prepayment protections and purchasing mortgage-related assets at a premium and at a discount.

Non-Agency MBS are high credit quality investment grade securities (AAA rated) not issued by government sponsored enterprises which are secured primarily by first-lien residential mortgage loans.

We classify our MBS as either trading investments, available-for-sale investments or held-to-maturity investments. Our management determines the appropriate classification of the securities at the time they are acquired and evaluates the appropriateness of such classifications at each balance sheet date. We currently classify all of our MBS as available-for-sale. All assets that are classified as available-for-sale are carried at fair value and unrealized gains or losses are included in Other comprehensive income or loss as a component of stockholders' equity. Losses on securities classified as available-for-sale which are determined by management to be other-than-temporary in nature are reclassified from other comprehensive income to income.

The most significant source of our revenue is derived from our investments in MBS. Interest income on our Agency MBS and Non-Agency MBS is accrued based on the actual coupon rate and the outstanding principal amount of the underlying mortgages. Premiums and discounts are amortized or accreted into interest income over the lives of the securities using the effective interest yield method, adjusted for the effects of actual prepayments based on the SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, or SFAS 91, an amendment of FASB Statements No. 13, 60 and 65 and a rescission of FASB Statement No. 17. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, street consensus prepayment speeds and current market conditions. If our estimate of prepayments is incorrect, as compared to the aforementioned references, we may be required to make an adjustment to the amortization or accretion of premiums and discounts that would have an impact on future income.

Securities are recorded on the date the securities are purchased or sold. Realized gains or losses from securities transactions are determined based on the specific identified cost of the securities.

The following table shows our investments' gross unrealized losses and fair value of those individual securities that have been in a continuous unrealized loss position at December 31, 2007, aggregated by investment category and length of time (dollar amounts in thousands):

Description of Securities	Less Than 12 Months			12 Months or More			Total		
	(dollar amounts in thousands, except for number of securities)								
	Number			Number			Number		
	of Securities	Fair Value	Unrealized Losses	of Securities	Fair Value	Unrealized Losses	of Securities	Fair Value	Unrealized Losses
Agency MBS	31	\$ 177,218	\$ (1,150)	405	\$ 1,113,199	\$ (16,228)	436	\$ 1,290,417	\$ (17,378)
Non-Agency MBS	2	\$ 42,714	\$ (7,003)		\$	\$	2	\$ 42,714	\$ (7,003)

We do not consider those Agency MBS that have been in a continuous loss position for 12 months or more to be other-than-temporarily impaired. The unrealized losses on our investments in Agency MBS were caused by fluctuations in interest rates. We purchased these investments primarily at a premium relative to their face value and the contractual cash flows of those investments are guaranteed by United States government-sponsored

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

enterprises and agencies. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because we have the ability and intent to hold those investments until a recovery of fair value up to (or beyond) its cost, which may be maturity, we do not consider these investments to be other-than-temporarily impaired at December 31, 2007.

Repurchase Agreements

We finance the acquisition of our MBS through the use of repurchase agreements. Under these repurchase agreements, we sell securities to a lender and agree to repurchase the same securities in the future for a price that is higher than the original sales price. The difference between the sale price that we receive and the repurchase price that we pay represents interest paid to the lender. Although structured as a sale and repurchase obligation, a repurchase agreement operates as a financing under which we pledge our securities as collateral to secure a loan which is equal in value to a specified percentage of the estimated fair value of the pledged collateral. We retain beneficial ownership of the pledged collateral. At the maturity of a repurchase agreement, we are required to repay the loan and concurrently receive back our pledged collateral from the lender or, with the consent of the lender, we may renew such agreement at the then prevailing financing rate. These repurchase agreements may require us to pledge additional assets to the lender in the event the estimated fair value of the existing pledged collateral declines.

Derivative Financial Instruments

Interest Rate Risk Management

We use primarily short-term (less than or equal to 12 months) repurchase agreements to finance the purchase of our MBS. These obligations expose us to variability in interest payments due to changes in interest rates. We continuously monitor changes in interest rate exposures and evaluate hedging opportunities.

Our objective is to limit the impact of interest rate changes on earnings and cash flows. We achieve this by entering into interest rate swap agreements which effectively converts a percentage of our repurchase agreements to fixed-rate obligations over a period of up to five years. Under interest rate swap contracts, we agree to pay an amount equal to a specified fixed rate of interest times a notional principal amount and to receive in return an amount equal to a specified variable-rate of interest times a notional amount, generally based on LIBOR. The notional amounts are not exchanged. We account for these swap agreements as cash flow hedges in accordance with FASB No. 133, *Accounting for Derivative Instruments and Hedging Activities*, or FASB 133. We do not issue or hold derivative contracts for speculative purposes.

We are exposed to credit losses in the event of non-performance by counterparties to these interest rate swap agreements, but we do not expect any of the counterparties to fail to meet their obligations. In order to limit credit risk associated with swap agreements, our current policy is to only purchase swap agreements from financial institution counterparties rated A or better by at least one of the rating agencies, limit our exposure on each swap agreement to a single counterparty under our defined guidelines and either pay or receive collateral to or from each counterparty on a periodic basis to cover the net fair market value position of the swap agreements held with that counterparty.

Accounting for Derivatives and Hedging Activities

In accordance with FASB 133, as amended by FASB No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, or FASB 138, a derivative that is designated as a hedge is recognized as an asset/liability and measured at estimated fair value. In order for our interest rate swap agreements to qualify for hedge accounting, upon entering into the swap agreement, we must anticipate that the hedge will be highly effective, as defined by FASB 133.

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On the date we enter into a derivative contract, we designate the derivative as a hedge of the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a cash flow hedge). Changes in the fair value of a derivative that are highly effective and that are designated and qualify as a cash flow hedge, to the extent that the hedge is effective, are recorded in Other comprehensive income and reclassified to income when the forecasted transaction affects income (e.g., when periodic settlement interest payments are due on repurchase agreements). The swap agreements are carried on our Consolidated Balance Sheets at their fair value based on values obtained from major financial institutions. Hedge ineffectiveness, if any, is recorded in current-period income.

We formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. If it is determined that a derivative is not (or has ceased to be) highly effective as a hedge, we discontinue hedge accounting.

When we discontinue hedge accounting, the gain or loss on the derivative remains in Accumulated other comprehensive income and is reclassified into income when the forecasted transaction affects income. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, we will carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value in current-period income.

For purposes of the cash flow statement, cash flows from derivative instruments are classified with the cash flows from the hedged item.

Credit Risk

At December 31, 2007, we had limited our exposure to credit losses on our portfolio of fixed-rate and adjustable-rate Agency MBS by purchasing primarily securities from Freddie Mac and Fannie Mae. The payment of principal and interest on the Freddie Mac and Fannie Mae MBS are guaranteed by those respective enterprises but are not guaranteed by the United States government. At December 31, 2007, because of the guarantee of these government-sponsored enterprises, all of these Agency MBS have an implied AAA rating.

Our adjustable-rate MBS are subject to periodic and lifetime interest rate caps. Periodic caps can limit the amount an interest rate can increase during any given period. Some adjustable-rate MBS subject to periodic payment caps may result in a portion of the interest being deferred and added to the principal outstanding.

Other-than-temporary losses on our available-for-sale MBS, as measured by the amount of decline in estimated fair value attributable to factors that are considered to be other-than-temporary, are charged against income, resulting in an adjustment of the cost basis of such securities. The following are among, but not all of, the factors considered in determining whether and to what extent an other-than-temporary impairment exists: (i) the expected cash flow from the investment; (ii) whether there has been an other-than-temporary deterioration of the credit quality of the underlying mortgages; (iii) the credit protection available to the related mortgage pool for MBS; (iv) any other market information available, including analysts' assessments and statements, public statements and filings made by the debtor or counterparty; (v) management's internal analysis of the security, considering all known relevant information at the time of assessment; and (vi) the magnitude and duration of historical decline in market prices. 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 decline exists and, if so, the amount considered impaired is also subjective and, therefore, constitutes material estimates that are susceptible to significant change.

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Income Taxes

We have elected to be taxed as a real estate investment trust, or REIT, and to comply with the provisions of the Code with respect thereto. Accordingly, we will not be subject to federal income tax to the extent that our distributions to stockholders satisfy the REIT requirements and certain asset, income and stock ownership tests are met.

Belvedere Trust Finance Corporation, or BT Finance, and BT Finance's wholly-owned subsidiaries, BT Residential Funding Corporation and BellaVista Funding Corporation, are taxable REIT subsidiaries, or TRS, of our company. In general, a TRS may hold assets that we cannot hold directly and may engage in any real estate or non-real estate related business. A TRS is subject to corporate federal and state income tax and will be taxed as a regular C corporation. Securities of a TRS will constitute non-real estate assets for purposes of determining whether at least 75% of a REIT's assets consist of real estate. Under current law, no more than 20% of a REIT's total assets can consist of securities of one or more TRS. At December 31, 2007, the amount of our assets attributable to our TRS was less than 10%. A more detailed description of federal income tax considerations regarding our qualifications and taxation as a REIT appears in this Annual Report on Form 10-K beginning on page 8.

The possible tax effect of the net operating losses and the net capital losses for Belvedere Trust and for the sales of securities appears in Note 6 to the accompanying unaudited consolidated financial statements.

On January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, or FIN 48. The adoption of FIN 48 had no effect on our financial statements. We have no unrecognized tax benefits and do not anticipate any increase in unrecognized benefits during 2007 relative to any tax positions taken prior to January 1, 2007. Should the accrual of any interest or penalties relative to unrecognized tax benefits be necessary, it is our policy to record such accruals in our income taxes accounts; no such accruals exist as of December 31, 2007. We file both REIT and taxable REIT subsidiary U.S. federal and California income tax returns. These returns are open to examination by taxing authorities for all years after 2002. Although the Internal Revenue Service, or the IRS, has closed their 2004 and 2005 exams in January 2007 for our taxable REIT subsidiary, those two years technically remain open under the statute of limitations.

Cumulative Convertible Preferred Stock

We classify our Series B Cumulative Convertible Preferred Stock, or Series B Preferred Stock, on the Consolidated Balance Sheets using the guidance in Emerging Issues Task Force (EITF) Topic D-98, *Classification and Measurement of Redeemable Securities*. The Series B Preferred Stock contains certain fundamental change provisions that allow the holder to redeem the preferred stock for cash only if certain events occur. As redemption under these circumstances is not solely within our control, we have classified the Series B Preferred Stock as temporary equity.

We have analyzed whether the conversion features in the Series B Preferred Stock should be bifurcated under the guidance in FASB No. 133, *Accounting for Derivative Instruments and Hedging Activities* and EITF Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock* and have determined that bifurcation is not necessary.

Stock-Based Compensation

As required by FASB Statement No. 123, *Accounting for Stock-Based Compensation*, or FASB 123, as amended by FASB Statement No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure An Amendment*, for the year ended December 31, 2005, we provided pro forma net income and

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

pro forma net income per common share disclosures for stock-based awards as if the fair-value-based method defined in FASB 123 had been applied. Under FASB Statement No. 123(R), Share-Based Payment, for the years ended December 31, 2006 and 2007, any compensation cost relating to share-based payment transactions is recognized in the consolidated financial statements. For the year ended December 31, 2005, had we determined compensation cost based on the fair value at the grant date for our stock options under FASB No. 123, our net income would have been reduced to the pro forma amounts indicated below for fiscal year ended December 31, 2005:

(in thousands, except per share amounts)	2005
Net income available to common stockholders, as reported	\$ 24,984
Add: Stock-based compensation expense included in Net Income	119
Less: Total stock-based compensation expense determined under the fair value-based method for all awards, net of related taxes	547
Pro forma net income	\$ 24,556
Basic income per share, as reported	\$ 0.53
Pro forma basic income per share	\$ 0.52
Diluted income per share, as reported	\$ 0.53
Pro forma diluted income per share	\$ 0.52

The fair value of the aforementioned stock-based awards was estimated using the Black-Scholes model with the following weighted-average assumptions for fiscal year ended December 31, 2005:

	2005
Assumptions:	
Dividend yield	6.00%
Expected volatility	29.00%
Risk-free interest rate	1.40%
Expected lives	1.0 years

In December 2005, our board of directors authorized the immediate vesting of all of our then-outstanding common stock options. We intend to utilize restricted stock grants instead of stock option grants in future employee compensation (see Note 10).

Restricted stock is expensed over the vesting period (see Note 10).

Earnings Per Share

Basic earnings per share, or EPS, is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS assumes the conversion, exercise or issuance of all potential common stock equivalents unless the effect is to reduce a loss or increase the income per share.

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The computation of EPS is as follows (amounts in thousands, except per share data):

	For the Year Ended December 31,		
	2007	2006	2005
(Loss) income from continuing operations	\$ (5,178)	\$ (11,441)	\$ 22,275
(Loss) income from discontinued operations	\$ (151,288)	\$ (2,763)	\$ 6,610
Net (loss) income	\$ (156,466)	\$ (14,204)	\$ 28,885
Dividend on Series A Cumulative Preferred Stock	\$ (3,033)	\$ (4,044)	\$ (3,901)
Dividend on Series B Cumulative Convertible Preferred Stock	\$ (1,716)	\$	\$
Net (loss) income available to common stockholders	\$ (161,215)	\$ (18,248)	\$ 24,984
Basic (loss) earnings per common share:			
Continuing operations	\$ (0.21)	\$ (0.34)	\$ 0.39
Discontinued operations	\$ (3.26)	\$ (0.06)	\$ 0.14
Total basic (loss) earnings per common share	\$ (3.47)	\$ (0.40)	\$ 0.53
Diluted (loss) earnings per common share:			
Continuing operations	\$ (0.21)	\$ (0.34)	\$ 0.39
Discontinued operations	\$ (3.26)	\$ (0.06)	\$ 0.14
Total basic (loss) earnings per common share	\$ (3.47)	\$ (0.40)	\$ 0.53
Basic weighted average number of shares outstanding	46,483	45,430	47,103
Diluted weighted average number of shares outstanding(1)	46,483	45,430	47,128

(1) During the years ended December 31, 2007 and 2006, the number of weighted average shares not included in Diluted EPS because of anti-dilution is 2.9 million and 18 thousand, respectively.

Accumulated Other Comprehensive Income (Loss)

FASB Statement No. 130, Reporting Comprehensive Income, divides comprehensive income into net income and other comprehensive income (loss), which includes unrealized gains and losses on marketable securities classified as available-for-sale, and unrealized gains and losses on derivative financial instruments that qualify for cash flow hedge accounting under FASB 133.

USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP in the United States of America 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 materially differ from those estimates.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued Statement No. 157, Fair Value Measurements. Prior to Statement No. 157, there were different definitions of fair value and limited guidance dispersed among many different accounting pronouncements. Statement No. 157 does not require any new fair value measurements. The changes to current practice resulting from the application of Statement No. 157 relate to the definition of fair value, the methods used to evaluate fair value and the expanded disclosures about fair value measurements. This guidance clarifies that the exchange price is the price in an orderly transaction between market participants to sell the asset

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Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

or transfer the liability in the principal (or most advantageous) market for the asset or liability. The fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. Statement No. 157 establishes a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (2) the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The notion of unobservable inputs is intended to allow for situations in which there is little, if any, market activity for the asset or liability at the measurement date. Statement No. 157 also clarifies that market participant assumptions include assumptions about risk and about the effects of a restriction on the sale or use of an asset. Statement No. 157 requires expanded disclosures about the extent to which fair value is used to measure recognized assets and liabilities, the inputs used to develop the measurements and the effect of certain of the measurements on earnings (or changes in net assets) for the period. The Company plans to adopt Statement No. 157 effective January 1, 2008. We do not believe Statement No. 157 will have a material impact on our financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Liabilities," or SFAS 159. SFAS 159 allows entities to make an election to record certain selected financial assets and liabilities at fair value on the balance sheet, with changes in fair value recorded in earnings. SFAS 159 will be effective for our financial statements for the fiscal year beginning January 1, 2008 and thereafter. We do not believe that SFAS 159 will affect the present treatment of available-for-sale securities and, therefore, do not believe that SFAS 159 will have a material impact on our financial statements.

NOTE 2. MORTGAGE-BACKED SECURITIES (MBS)

The following tables summarize our Agency MBS and Non-Agency MBS classified as available-for-sale as of December 31, 2007 and December 31, 2006 which are carried at their fair value (amounts in thousands):

December 31, 2007

Agency MBS (By Agency)	Ginnie Mae	Freddie Mac	Fannie Mae	Total Agency MBS
Amortized cost	\$ 35,854	\$ 1,193,972	\$ 3,403,050	\$ 4,632,876
Paydowns receivable		15,420		15,420
Unrealized gains		10,389	21,240	31,629
Unrealized losses	(628)	(4,490)	(12,260)	(17,378)
Fair value	\$ 35,226	\$ 1,215,291	\$ 3,412,030	\$ 4,662,547

Agency MBS (By Security Type)	ARMs	Hybrids	Fixed-Rate	Floating-Rate CMOs	Total Agency MBS
Amortized cost	\$ 917,566	\$ 2,887,833	\$ 818,160	\$ 9,317	\$ 4,632,876
Paydowns receivable	9,984	5,436			15,420
Unrealized gains	706	22,944	7,927	52	31,629
Unrealized losses	(10,075)	(623)	(6,680)		(17,378)
Fair value	\$ 918,181	\$ 2,915,590	\$ 819,407	\$ 9,369	\$ 4,662,547

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Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Total Non-Agency MBS
Non-Agency MBS	
Amortized cost	\$ 49,717
Paydowns receivable	
Unrealized gains	
Unrealized losses	(7,003)
Fair value	\$ 42,714

At December 31, 2007, our Non-Agency MBS consisted of CMO floaters with an average coupon of 5.11% which were acquired at par value.

During the third quarter of 2007 (when there was liquidity and credit problems surrounding the mortgage markets generally), we sold approximately \$904 million in Agency MBS and Non-Agency MBS and realized a loss of approximately \$23.4 million.

December 31, 2006

		Freddie Mac	Fannie Mae	Total Agency MBS
Agency MBS (By Agency)	Ginnie Mae			
Amortized cost	\$ 55,771	\$ 1,714,520	\$ 2,932,365	\$ 4,702,656
Paydowns receivable		26,771		26,771
Unrealized gains		5,127	940	6,067
Unrealized losses	(972)	(17,893)	(37,722)	(56,587)
Fair value	\$ 54,799	\$ 1,728,525	\$ 2,895,583	\$ 4,678,907

				Floating-Rate CMOs	Total Agency MBS
Agency MBS (By Security Type)	ARMs	Hybrids	Fixed-Rate		
Amortized cost	\$ 1,220,896	\$ 2,714,172	\$ 756,768	\$ 10,820	\$ 4,702,656
Paydowns receivable	12,241	14,530			26,771
Unrealized gains	53	1,523	4,371	120	6,067
Unrealized losses	(20,108)	(25,819)	(10,660)		(56,587)
Fair value	\$ 1,213,082	\$ 2,704,406	\$ 750,479	\$ 10,940	\$ 4,678,907

	Total Non-Agency MBS
Non-Agency MBS	
Amortized cost	\$ 107,023

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Paydowns receivable

Unrealized gains

Unrealized losses

Fair value	\$ 107,023
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At December 31, 2006, our Non-Agency MBS consisted of CMO floaters with an average coupon of 5.61% which were acquired at par value.

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Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

With the continued increases in the Federal Funds rate in 2005 and 2006, management determined that it did not intend to hold certain of its Agency MBS until maturity and would sell a selective portion of its assets as a part of its asset/liability management program. Based on various factors, we identified those securities that would be sold. We were able to sell all of these identified Agency MBS in the second quarter of 2006 and recorded a loss of approximately \$10.2 million on the sale of approximately \$398 million in face amount of Agency MBS. We used the specific identification method in determining the loss on each security sold. We used the proceeds of the sales to invest in higher-yielding Agency MBS. There were no sales of Agency MBS in the fourth quarter of 2006. Our general policy continues to be to hold Agency MBS until a recovery of fair value up to (or beyond) this cost.

NOTE 3. REPURCHASE AGREEMENTS

We have entered into repurchase agreements with major financial institutions to finance most of our Agency MBS. The repurchase agreements are short-term borrowings that are secured by the market value of our MBS and bear fixed interest rates that have historically had their basis on LIBOR. Relative to our Agency MBS portfolio, at December 31, 2007, our repurchase agreements had a weighted average term to maturity of 49 days and a weighted average borrowing rate of 4.91%. After adjusting for swap transactions, the weighted average term to the next rate adjustment was 418 days with a weighted average borrowing rate of 4.77%. At December 31, 2007, Agency MBS with a fair value of approximately \$4.48 billion have been pledged as collateral under the repurchase agreements.

Relative to our Agency MBS and Non-Agency MBS portfolios, at December 31, 2006, our repurchase agreements had a weighted average term to maturity of 90 days and a weighted average borrowing rate of 5.36%. After adjusting for swap transactions, the weighted average term to the next rate adjustment was 301 days with a weighted average borrowing rate of 5.19%. At December 31, 2006, Agency MBS with a fair value of approximately \$4.45 billion have been pledged as collateral under the repurchase agreements.

At December 31, 2007 and 2006, the repurchase agreements had the following remaining maturities:

	December 31, 2007	December 31, 2006
Less than 3 months	95.4%	59.1%
3 months to less than 1 year	1.8	40.9
1 year to 2 years	2.8	
Total:	100.0%	100.0%

NOTE 4. JUNIOR SUBORDINATED NOTES

On March 15, 2005, we issued \$37,380,000 of junior subordinated notes to a newly-formed statutory trust, Anworth Capital Trust I, organized by us under Delaware law. The trust issued \$36,250,000 in trust preferred securities to unrelated third party investors. Both the notes and the trust preferred securities require quarterly payments and bear interest at the prevailing three-month LIBOR rate plus 3.10%, reset quarterly. The first interest payment was made on June 30, 2005. Both the notes and the securities will mature in 2035 and may be redeemable, in whole or in part, without penalty, at our option, after March 30, 2010 and April 30, 2010. We used the net proceeds of this private placement to invest in Agency MBS. We have reviewed the structure of the transaction under FIN 46 and concluded that Anworth Capital Trust I does not meet the requirements for consolidation. On September 26, 2005, the notes, the trust preferred securities and the related agreements were amended. The only material change was that one of the class holders requested that interest payments be made quarterly on January 30, April 30, July 30 and October 30 instead of at the end of each calendar quarter. This became effective with the quarterly payment after September 30, 2005.

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5. FAIR VALUES OF FINANCIAL INSTRUMENTS

Our Agency MBS and Non-Agency MBS are reflected in the consolidated financial statements at estimated fair value. Management bases its fair value estimates for our Agency MBS and Non-Agency MBS primarily on third-party bid price indications provided by dealers who make markets in these financial instruments when such indications are available. However, the fair value reported reflects estimates and may not necessarily be indicative of the amounts we could realize in a current market exchange.

Cash and cash equivalents, restricted cash, interest receivable, repurchase agreements, interest payable and payables for securities purchased are reflected in the consolidated financial statements at their costs, which approximates their fair value because of the nature and short term of these instruments.

NOTE 6. INCOME TAXES

We have elected to be taxed as a REIT and to comply with the provisions of the Code with respect thereto. Accordingly, we will not be subject to federal income tax to the extent that our distributions to stockholders satisfy the REIT requirements and certain asset, income and stock ownership tests are met.

BT Finance and BT Finance's wholly-owned subsidiaries, BT Residential Funding Corporation and Bella Vista Funding Corporation, are taxable REIT subsidiaries (TRS) of the Company. A TRS is subject to corporate federal and state income tax and will be taxed as a regular C corporation.

As of December 31, 2007, BT Finance's net operating loss carryforwards were approximately \$1.33 million for both federal and state purposes. The federal and state net operating losses begin to expire in the years 2024 and 2014, respectively. Under Internal Revenue Code Sec. 382, certain changes in the ownership structure may limit the annual usage of the net operating losses. The management does not believe such a change in the ownership structure occurred during the year.

The loss from the sales of our MBS are capital losses and can only be offset against capital gains or future capital gains within five years. The loss from the sales and impairments on sales of Belvedere Trust's assets are capital losses and can only be offset against capital gains or future capital gains within five years.

On January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, or FIN 48. The adoption of FIN 48 had no effect on our financial statements. We have no unrecognized tax benefits and do not anticipate any increase in unrecognized benefits during 2007 relative to any tax positions taken prior to January 1, 2007. Should the accrual of any interest or penalties relative to unrecognized tax benefits be necessary, it is our policy to record such accruals in our income taxes accounts; no such accruals exist as of January 1, 2007. We file both REIT and taxable REIT subsidiary U.S. federal and California income tax returns. These returns are open to examination by taxing authorities for all years after 2002. Although the IRS closed its 2004 and 2005 exams in January 2007 for our taxable REIT subsidiary, those two years technically remain open under the statute of limitations.

Income tax expense (benefit) for the years ended December 31, 2007 and 2006 was zero. None of the components of income tax expense are significant on a separately stated basis.

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Based on the activity of our taxable REIT subsidiaries, a reconciliation of the expected federal income tax expense using the federal statutory tax rate of 34% to actual income tax expense for the years ended December 31, 2007 and 2006 is as follows (in thousands):

	2007		2006	
Income tax at statutory rate	\$ (24)	34.0%	\$ (12)	34.0%
State taxes, net	(4)	5.8%	(2)	5.8%
Gain on asset securitization				
Valuation allowance	28	(39.8)%	14	(39.8)%
Total income tax expenses	\$	0.00%	\$	(0.00)%

Significant components of the deferred tax assets and liabilities at December 31, 2007 and 2006 were as follows (in thousands):

	2007	2006
Deferred tax assets:		
Prepaid expenses for taxes	\$ 189	\$
Net operating losses	529	696
 Gross deferred tax assets	 718	 696
Valuation allowance	(718)	(690)
 Deferred tax asset		6
Deferred tax liabilities:		
General and administrative expenses		(6)
 Deferred tax liability		(6)
 Net deferred tax asset/liability	 \$	 \$

Based on facts and circumstances, we believe it is more likely than not that the deferred tax assets will not be utilized in the foreseeable future. Therefore, a full valuation allowance was recorded.

NOTE 7. SERIES B CUMULATIVE CONVERTIBLE PREFERRED STOCK

On February 1 and 7, 2007, we issued an aggregate of 1.15 million shares of Series B Preferred Stock and received net proceeds of approximately \$27 million (net of underwriting fees, commissions and other costs). The Series B Preferred Stock has a par value of \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series B Preferred Stock must be paid a dividend at a rate of 6.25% per year on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series B Preferred Stock is senior to the common stock and on parity with our Series A Preferred Stock with respect to the payment of distributions and amounts, upon liquidation, dissolution or winding up.

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The Series B Preferred Stock has no maturity date and is not redeemable. The Series B Preferred Stock is convertible at an initial conversion rate of 2.3809 shares of our common stock per \$25.00 liquidation preference. The conversion rate will be adjusted in any fiscal quarter in which the cash dividends paid to common stockholders results in an annualized common stock dividend yield which is greater than 6.25%. The conversion ratio will also be subject to adjustment upon the occurrence of certain specific events such as a change of control. The Series B Preferred Stock is convertible into shares of our common stock at the option of the Series B preferred stockholder at any time at the then prevailing conversion rate. On or after January 25, 2012, we may, at our option, convert, under certain circumstances, each share of Series B Preferred Stock into a number of

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

common shares at the then prevailing conversion rate. The Series B Preferred Stock contains certain fundamental change provisions that allow the holder to redeem the preferred stock for cash only if certain events occur. The Series B Preferred Stock generally does not have voting rights, except if dividends on the Series B Preferred Stock are in arrears for six or more quarterly periods (whether or not consecutive). Under such circumstances, Series B preferred stockholders, together with our Series A preferred stockholders, will be entitled to vote to elect two additional directors to our board of directors to serve until all unpaid dividends have been paid or declared and set apart for payment. In addition, certain material and adverse changes to the terms of the Series B Preferred Stock may not be taken without the affirmative vote of at least two-thirds of the outstanding shares of Series B Preferred Stock and Series A Preferred Stock voting together as a single class. Through December 31, 2007, we have declared and set aside for payment the required dividend for the Series B Preferred Stock.

NOTE 8. PUBLIC OFFERINGS AND CAPITAL STOCK

Our Dividend Reinvestment and Stock Purchase Plan allows stockholders and non-stockholders to purchase shares of our common stock and to reinvest dividends in additional shares of our common stock. During the year ended December 31, 2007, we issued approximately 209 thousand shares of common stock under the plan, resulting in proceeds to us of approximately \$1.3 million.

During the three months ended September 30, 2007, we granted a total of 8 thousand shares of common stock to our independent directors for approximately \$72 thousand.

On May 23, 2007, we filed a shelf registration statement on Form S-3 with the SEC, offering up to \$500 million of our capital stock. The registration statement was declared effective on June 8, 2007. At December 31, 2007, \$423.2 million of this amount remained available for issuance under the registration statement.

On June 29, 2007, we entered into a Controlled Equity Offering Sales Agreement, or the Sales Agreement, with Cantor Fitzgerald & Co., or Cantor, to reinstate and modify a controlled equity offering program, or the Equity Program, under which Cantor will act as sales agent. Under the Equity Program, the Company, in its sole discretion, may sell, from time to time, an aggregate of up to 10 million shares of our common stock, 1.225 million shares of our Series A Preferred Stock and 2.0 million shares of our Series B Preferred Stock.

We initially instituted the Equity Program with Cantor in December 2002. In 2005, we amended the Equity Program with Cantor to allow us to sell an additional amount of common stock and up to 2.0 million shares of Series A Preferred Stock. In June 2007, we entered into the Sales Agreement in order to (i) reduce the commission rate payable to Cantor on any sales of our Series A Preferred Stock, Series B Preferred Stock and common stock from a rate of up to 3% to a rate of between 2.0% and 2.5%; and (ii) permit us to sell shares of our Series B Preferred Stock through the Equity Program. Sales of our Series A Preferred Stock, Series B Preferred Stock and common stock made under the Equity Program will be made on the New York Stock Exchange or on any other existing trading market by means of ordinary brokers' transactions at market prices and through privately negotiated transactions. From June 29, 2007 through December 31, 2007, we sold 56 thousand shares of our Series B Preferred Stock under the Equity Program, which provided net proceeds to us of approximately \$1.38 million. The sales agent received an aggregate of approximately \$28 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share. From June 29, 2007 through December 31, 2007, we sold 1,115,100 shares of our common stock under the Equity Program, which provided net proceeds to us of approximately \$9.1 million. The sales agent received an aggregate of approximately \$214 thousand, which represents an average commission of approximately 2.3% on the gross sales price per share.

During the year ended December 31, 2006, we repurchased 37,500 shares of our common stock at an average price paid per share of \$7.57. During the year ended December 31, 2007, we did not repurchase any shares of our common stock.

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On November 7, 2005, we filed a registration statement on Form S-8 to register an aggregate of up to 3.5 million shares of our common stock to be issued pursuant to the Anworth Mortgage Asset Corporation 2004 Equity Compensation Plan, or the 2004 Equity Plan.

In December 2007, we issued 10.35 million shares of common stock and received net proceeds of approximately \$65.5 million, net of underwriting commissions and offering expenses.

At December 31, 2007, our authorized capital included 20 million shares of \$0.01 par value preferred stock, of which 5.15 million shares had been designated 8.625% Series A Cumulative Preferred Stock (liquidation preference \$25.00 per share) and 3.15 million shares had been designated 6.25% Series B Cumulative Convertible Preferred Stock (liquidation preference \$25.00 per share). The remaining preferred stock may be issued in one or more classes or series, with such distinctive designations, rights and preferences as determined by our board of directors.

NOTE 9. TRANSACTIONS WITH AFFILIATES

Anworth 2002 Incentive Compensation Plan

Under our 2002 Incentive Compensation Plan, or the 2002 Incentive Plan, eligible employees have the opportunity to earn incentive compensation for each fiscal quarter. The total aggregate amount of compensation that may be earned by all employees equals a percentage of taxable net income, before incentive compensation, in excess of the amount that would produce an annualized return on average net worth equal to the ten-year U.S. Treasury Rate plus 1%, or the Threshold Return.

The 2002 Incentive Plan contains a high water mark provision requiring that in any fiscal quarter in which our taxable net income is an amount less than the amount necessary to earn the Threshold Return, we will calculate negative incentive compensation for that fiscal quarter which will be carried forward and will offset future incentive compensation earned under the 2002 Incentive Plan, but only with respect to those participants who were participants during the fiscal quarter(s) in which negative incentive compensation was generated.

The percentage of taxable net income in excess of the Threshold Return earned under the 2002 Incentive Plan by all employees is calculated based on our quarterly average net worth as defined in the 2002 Incentive Plan. The percentage rate used in this calculation is based on a blended average of the following tiered percentage rates:

25% for the first \$50 million of average net worth;

15% for the average net worth between \$50 million and \$100 million;

10% for the average net worth between \$100 million and \$200 million; and

5% for the average net worth in excess of \$200 million.

The 2002 Incentive Plan requires that we pay all amounts earned thereunder each quarter (subject to offset for accrued negative incentive compensation) and we will be required to pay a percentage of such amounts to certain of our executives pursuant to the terms of their employment agreements. During the years ended December 31, 2007 and 2006, eligible employees under the 2002 Incentive Plan did not earn any incentive compensation. At December 31, 2007 and 2006, there was a negative incentive compensation accrual carried forward of \$21.4 million and \$4.8 million, respectively. During the year ended December 31, 2005, eligible employees under the 2002 Incentive Plan earned \$708 thousand in incentive compensation.

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Employment Agreements

Pursuant to the terms of employment agreements with us, Lloyd McAdams serves as our President, Chairman and Principal Executive Officer, Joseph E. McAdams serves as our Chief Investment Officer and Executive Vice President, and Heather U. Baines serves as our Executive Vice President. Pursuant to the terms of his employment agreement, Lloyd McAdams receives a base salary of \$630 thousand per annum. Pursuant to the terms of his employment agreement, Joseph E. McAdams receives a base salary equal to \$420 thousand per annum. Ms. Baines receives a \$53 thousand annual base salary. The terms of the employment agreements were originally for three years following June 13, 2002 and automatically renew for one-year terms unless written notice is provided by either party six months prior to the end of the current term.

These employment agreements, including all addenda thereto, also have the following provisions:

the three executives are entitled to participate in our 2002 Incentive Plan and each of these individuals are provided a minimum percentage of the amounts earned under such plan. Lloyd McAdams is entitled to 45% of all amounts paid under the plan; Joseph E. McAdams is entitled to 25% of all amounts paid under the plan; and Ms. Baines is entitled to 5% of all amounts paid under the plan. The three executives may be paid up to 50% of their respective incentive compensation earned under such plan in the form of our common stock;

the 2002 Incentive Compensation Plan may not be amended without the consent of the three executives;

in the event of a registered public offering of our shares, the three executives are entitled to piggyback registration rights in connection with such offering;

in the event any of the three executives is terminated without cause, or if they terminate for good reason, or in the case of Lloyd McAdams or Joseph E. McAdams, their employment agreements are not renewed, then the executives would be entitled to (1) all base salary due under the contracts, (2) all discretionary bonus due under the contracts, (3) a lump sum payment of an amount equal to three years of the executive's then-current base salary, (4) payment of COBRA medical coverage for eighteen months, (5) immediate vesting of all pension benefits, (6) all incentive compensation to which the executives would have been entitled to under the contract prorated through the termination date, and (7) all expense reimbursements and benefits due and owing the executives through the termination. In addition, under these circumstances, Lloyd McAdams and Joseph E. McAdams would each be entitled to a lump sum payment equal to 150% of the greater of (i) the highest amount paid or that could be payable (in the aggregate) under the 2002 Incentive Plan during any one of the three fiscal years prior to their termination, and (ii) the highest amount paid, or that could be payable (in the aggregate), under the plan during any of the three fiscal years following their termination. Ms. Baines would also be entitled to a lump sum payment equal to all incentive compensation that Ms. Baines would have been entitled to under the plan during the three-year period following her termination;

the three executives received restricted stock grants of 20,000 shares each, which grants vest in equal, annual installments over ten years beginning June 13, 2002;

the equity awards granted to each of the three executives will immediately vest upon the termination of the executive's employment upon a change in control; and

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Lloyd McAdams and Joseph E. McAdams are each subject to a one-year non-competition provision following termination of their employment except in the event of a change in control.

On June 27, 2006, we entered into addenda to our employment agreements with each of Lloyd McAdams, Joseph E. McAdams and Ms. Baines. The addenda amend the employment agreements with Lloyd McAdams, Joseph E. McAdams and Ms. Baines to, among other things, (i) comply with Section 409A of the Internal Revenue Code of 1986, as amended, as enacted in the American Jobs Creation Act of 2004, (ii) modify certain non-competition provisions in the employment agreements with Lloyd McAdams and Joseph E. McAdams, (iii) remove certain non-competition provisions from the employment agreement with Ms. Baines and (iv) make certain other clarifications to the agreements.

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Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

On June 27, 2006, we entered into Change in Control and Arbitration Agreements with each of Thad M. Brown, our Principal Financial Officer, Charles J. Siegel, our Senior Vice President-Finance, Evangelos Karagiannis, our Vice President and Portfolio Manager, and Bistra Pashamova, our Vice President and Portfolio Manager, as well as certain of our other employees. The Change in Control and Arbitration Agreements grant these officers and employees in the event that a change in control occurs a lump sum payment equal to (i) 12 months annual base salary in effect on the date of the change in control, plus (ii) the average annual incentive compensation received for the two complete fiscal years prior to the date of the change on control, and plus (iii) the average annual bonus received for the two complete fiscal years prior to the date of the change in control, as well as other benefits. The Change in Control and Arbitration Agreements also provide for accelerated vesting of equity awards granted to these officers and employees upon a change in control.

Agreements with Pacific Income Advisers, Inc.

On June 13, 2002, we entered into a sublease with Pacific Income Advisers, Inc., or PIA, a company owned by a trust controlled by certain of our officers. Under the sublease, we lease, on a pass-through basis, 5,500 square feet of office space from PIA and pay rent at a rate equal to PIA's obligation, currently \$51.05 per square foot. The sublease runs through June 30, 2012 unless earlier terminated pursuant to the master lease. During the year ended December 31, 2007, we paid \$277 thousand in rent to PIA under the sublease which is included in Other expenses on the Consolidated Statements of Income. During the years ended December 31, 2006 and 2005, we paid \$269 thousand and \$261 thousand, respectively, in rent to PIA under this sublease.

The future minimum lease commitment is as follows (in whole dollars):

Year	2008	2009	2010	2011	2012	Total Commitment
Commitment	\$ 284,965	\$ 293,515	\$ 302,332	\$ 311,414	\$ 158,012	\$ 1,350,238

On October 14, 2002, we entered into an administrative agreement with PIA. Under the administrative agreement, PIA provides administrative services and equipment to us in the nature of accounting, human resources, operational support and information technology, and we pay an annual fee of 7 basis points on the first \$225 million of stockholders' equity and 3.5 basis points thereafter (paid quarterly in advance) for those services. The administrative agreement is for an initial term of one year and will renew for successive one-year terms thereafter unless either party gives notice of termination no less than 30 days before the expiration of the then-current annual term. We may also terminate the administrative agreement upon 30 days prior written notice for any reason and immediately if there is a material breach by PIA. Included in

Other expenses on the Consolidated Statements of Income are fees of \$264 thousand paid to PIA in connection with this agreement during the year ended December 31, 2007. During the years ended December 31, 2006 and 2005, we paid fees of \$200 thousand and \$277 thousand, respectively, to PIA in connection with this agreement.

Deferred Compensation Plan

On January 15, 2003, we adopted the Anworth Mortgage Asset Corporation Deferred Compensation Plan, or the Deferred Compensation Plan. We amended the plan effective January 1, 2005 to comply with Section 409A of the Code enacted as part of the American Jobs Creation Act of 2004. The Deferred Compensation Plan permits our eligible officers to defer the payment of all or a portion of their cash compensation that otherwise would be in excess of the \$1 million annual limitation on deductible compensation imposed by Section 162(m) of the Code (based on the officers' compensation and benefit elections made prior to January 1 of the calendar year in which the compensation will be deferred). Under this limitation, compensation paid to our Principal Executive Officer and our four other highest paid officers is not deductible by us for income tax purposes to the extent the amount paid to any such officer exceeds \$1 million in any calendar year, unless such compensation qualifies as performance-based compensation under Section 162(m). Our board of directors designates the eligible officers who may participate in

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

the Deferred Compensation Plan from among the group consisting of our Principal Executive Officer and our other four highest paid officers. To date, the board has designated Lloyd McAdams, our Chairman, President and Principal Executive Officer, and Joseph E. McAdams, our Chief Investment Officer and Executive Vice President, as the only officers who may participate in the Deferred Compensation Plan. Each eligible officer becomes a participant in the Deferred Compensation Plan by making a written election to defer the payment of cash compensation. With certain limited exceptions, the election must be filed with us before January 1 of the calendar year in which the compensation will be deferred. The election is effective for the entire calendar year and may not be terminated or modified for that calendar year. If a participant wishes to defer compensation in a subsequent calendar year, a new deferral election must be made before January 1 of that subsequent year.

Amounts deferred under the Deferred Compensation Plan are not paid to the participant as earned, but are credited to a bookkeeping account maintained by us in the name of the participant. The balance in the participant's account is credited with earnings at a rate of return equal to the annual dividend yield on our common stock. The balance in the participant's account is paid to the participant six months after termination of employment or upon the death of the participant or a change in control of our company. Each participant is a general unsecured creditor of our company with respect to all amounts deferred under the Deferred Compensation Plan.

NOTE 10. EQUITY COMPENSATION PLAN

At our May 27, 2004 annual stockholders' meeting, our stockholders adopted the Anworth Mortgage Asset Corporation 2004 Equity Compensation Plan, or the Plan, which amended and restated our 1997 Stock Option and Awards Plan. The Plan authorized the grant of stock options and other stock-based awards, as of December 31, 2005, for an aggregate of up to 3,500,000 of the outstanding shares of our common stock. The Plan authorizes our board of directors, or a committee of our Board, to grant incentive stock options, as defined under section 422 of the Code, options not so qualified, restricted stock, dividend equivalent rights (DERs), phantom shares, stock-based awards that qualify as performance-based awards under Section 162(m) of the Code and other stock-based awards. The exercise price for any option granted under the Plan may not be less than 100% of the fair market value of the shares of common stock at the time the option is granted. At December 31, 2007, 1,212,402 shares remained available for future issuance under the Plan through any combination of stock options or other awards. The Plan does not provide for automatic annual increases in the aggregate share reserve or the number of shares remaining available for grant. We filed a registration statement on Form S-8 on November 7, 2005 to register an aggregate of up to 3,500,000 shares of our common stock to be issued pursuant to the Plan.

A summary of stock option transactions for the plan follows:

	2007		2006		2005	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	1,360,930	\$ 12.123	1,385,930	\$ 12.045	1,383,930	\$ 12.042
Granted					5,000	9.720
Exercised						
Expired			(25,000)	7.81	(3,000)	7.100
Outstanding, end of year	1,360,930	\$ 12.123	1,360,930	\$ 12.123	1,385,930	\$ 12.045
Weighted average fair value of options granted during the year						0.90
Options exercisable at year-end	1,360,930		1,360,930		1,385,930	

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes information about stock options outstanding at December 31, 2007:

Exercise Price	Options	
	Outstanding and	Remaining
	Exercisable at	Contractual
	December 31, 2007	Life (Years)
\$ 4.60	2,644	1.3
\$ 6.70	520	3.5
\$ 7.10	6,000	3.6
\$ 9.00	65,961	0.2
\$ 9.45	127,505	4.1
\$11.20	264,000	4.8
\$11.25	10,000	4.8
\$13.80	427,300	5.3
\$12.47	452,000	1.3
\$ 9.72	5,000	7.6
	1,360,930	

The following table summarizes information about restricted stock outstanding at December 31, 2007:

Grant Price	Unvested	Restricted Shares Granted	Shares		Unvested	Weighted Average Remaining Contractual Life (Years)
	Shares at December 31, 2006		Vested at December 31, 2007	Shares Forfeited	Shares at December 31, 2007	
\$7.72	180,705		35,619		145,086	7.8
\$9.12	197,362				197,362	8.8
	378,067		35,619		342,448	8.4

In October 2005, our board of directors approved the grant of 200,780 shares of restricted stock to various of our employees under our 2004 Equity Plan. The stock price on the grant date was \$7.72. The restricted stock vests 10% per year on each anniversary date for a ten-year period and shall also vest immediately upon the death of the grantee or upon the grantee reaching age 65. Each grantee shall have the right to sell 40% of the restricted stock anytime after such shares have vested. The remaining 60% of such vested restricted stock may not be sold until after termination of employment with us. We amortize the restricted stock over the vesting period, which is the lesser of ten years or the remaining number of years to age 65.

In October 2006, our board of directors approved a grant of an aggregate of 197,362 shares of performance-based restricted stock to various of our officers and employees under our 2004 Equity Plan. Such grant was made effective on October 18, 2006. The closing stock price on the effective date of the grant was \$9.12. The shares will vest in equal annual installments over the next three years provided that the annually compounded rate of return on our common stock, including dividends, exceeds 12% measured from the effective date of the grant to each of the next three anniversary dates. If the annually compounded rate of return does not exceed 12%, then the shares will vest on the anniversary date

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thereafter when the annually compounded rate of return exceeds 12%. If the annually compounded rate of return does not exceed 12% within ten years after the effective date of the grant, then the shares will be forfeited. The shares will fully vest within the ten-year period upon the death of a grantee. Upon vesting, each grantee shall have the right to sell 40% of the restricted stock anytime after such shares have vested. The remaining 60% of such vested restricted stock may not be sold until after termination of employment with us or upon the tenth anniversary of the effective date.

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Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

At our May 24, 2007 annual meeting of stockholders, our stockholders adopted the Anworth Mortgage Asset Corporation 2007 Dividend Equivalent Rights Plan, or the 2007 Dividend Equivalent Rights Plan. As of December 31, 2007, no grants under the 2007 Dividend Equivalent Rights Plan have been issued to our employees, officers or directors. A dividend equivalent right, or DER, is a right to receive amounts equal in value to the dividend distributions paid on a share of our common stock. DERs are paid in either cash or shares of our common stock, whichever is specified by our Compensation Committee at the time of grant, at such times as dividends are paid on shares of our common stock during the period between the date a DER is issued and the date the DER expires or earlier terminates. The committee may impose such other conditions to the grant of DERs as it may deem appropriate. The maximum term for DERs under the 2007 Dividend Equivalent Rights Plan is ten years from the date of grant. There were no awards of DERs granted during 2007.

NOTE 11. HEDGING INSTRUMENTS

At December 31, 2007, we were a counter-party to swap agreements, which are derivative instruments as defined by FASB 133 and FASB 138, with an aggregate notional amount of \$2.04 billion and a weighted average maturity of 2.4 years. During the year ended December 31, 2007, we entered into sixteen new swap agreements with an aggregate notional amount of \$1.24 billion. Of these new swap agreements, one with a notional amount of \$100 million was terminated during 2007, resulting in a realized loss of \$123 thousand. Another swap agreement with a notional amount of \$100 million matured during 2007. We utilize swap agreements to manage interest rate risk relating to our repurchase agreements and do not anticipate entering into derivative transactions for speculative or trading purposes. In accordance with the swap agreements, we will pay a fixed-rate of interest during the term of the swap agreements and receive a payment that varies with the three-month LIBOR rate.

At December 31, 2007, there was a decrease of \$48.3 million, from \$4.9 million in unrealized gains at December 31, 2006 to \$43.4 million in unrealized losses, on our swap agreements included in Other comprehensive income (this decrease consisted of unrealized losses on cash flow hedges of \$39.7 million and a reclassification adjustment for interest income included in net loss of \$8.6 million) and are presented as Derivative instruments at fair value on the Consolidated Balance Sheets as an asset of \$1.8 million and a liability of \$45.2 million.

At December 31, 2007, we have provided cash as collateral on swap margin calls (included in Other assets) of \$48.1 million.

For the year ended December 31, 2007, there was a loss of approximately \$23 thousand recognized in earnings due to hedge ineffectiveness. There were no components of the derivative instruments gain or loss excluded from the assessment of hedge effectiveness. As of December 31, 2007, the estimated amount of net losses that is expected to be reclassified into earnings within the next twelve months due to when the forecasted transaction affects income (i.e., when the periodic settlement interest payments are due) is \$9.3 million. The maximum length of our swap agreements is five years. We do not anticipate any discontinuance of the swap agreements and thus do not expect to recognize any gain or loss into earnings because of this.

NOTE 12. CUMULATIVE ADJUSTMENT

In December 2005, we declared a Series A Preferred Stock dividend of approximately \$1 million for preferred stockholders of record as of March 31, 2006 and payable on April 17, 2006. We recorded this preferred stock dividend in the first quarter of 2006 instead of recording it in December 2005. We do not believe that this amount was material to our December 31, 2005 financial statements. In analyzing this transaction under the provisions of SEC Staff Accounting Bulletin No. 108, or SAB 108, we determined that an adjustment to our December 31, 2006 financial statements was necessary. We have, in accordance with the transition provision of

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

SAB 108, recorded a cumulative effect adjustment within the equity section of our December 31, 2006 Consolidated Balance Sheets to correct this transaction. The effect of this adjustment increased the preferred stock dividends payable and increased the accumulated deficit within stockholders' equity by approximately \$1 million. This adjustment had no effect to the loss to common stockholders and no effect to common stock EPS for the year ended December 31, 2006. We have also corrected in Note 15 the quarterly information relating to this adjustment for the preferred stock dividend, net income available to common stockholders, basic and diluted EPS and dividends declared per preferred share for the first and fourth quarters of 2006. The first quarter 2006 basic and diluted EPS increased by \$0.02 per share and the fourth quarter 2006 basic and diluted EPS decreased by \$0.02 per share.

NOTE 13. COMMITMENTS AND CONTINGENCIES

- (a) Lease Commitment and Administrative Services Commitment We sublease office space and use administrative services from PIA, as more fully described in Note 9.

NOTE 14. OTHER EXPENSES

	Year Ended December 31,		
	2007	2006	2005
	(in thousands)		
Legal and accounting fees	\$ 715	\$ 427	\$ 630
Printing and stockholder communications	115	110	152
Directors and Officers insurance	374	387	368
Software implementation and maintenance	222	207	199
Administrative service fees	250	169	260
Rent	277	268	261
Stock exchange and filing fees	157	92	179
Custodian fees	127	142	125
Sarbanes-Oxley consulting fees	151	153	116
Board of Directors fees and expenses	419	342	292
Securities data services	117	178	49
Other	266	308	234
Total of other expenses:	\$ 3,190	\$ 2,783	\$ 2,865

NOTE 15. SUMMARIZED QUARTERLY RESULTS (UNAUDITED)

The following tables summarize quarterly results for the years ended December 31, 2007 and 2006 (unaudited). Earnings per share amounts for each quarter and the full years have been calculated separately. Accordingly, quarterly amounts may not add to the annual amounts because of substantial differences in the average shares outstanding during each period and, with regard to diluted earnings per share amounts, they may also differ because of the inclusion of the effect of potentially dilutive securities only in the periods in which such effect would have been dilutive.

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

For the year ended December 31, 2007 (in thousands, except per share amounts):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income net of amortization of premium and discount:				
Interest on Agency MBS	\$ 62,167	\$ 62,606	\$ 61,125	\$ 57,955
Interest on Non-Agency MBS	1,682	1,634	1,011	651
	63,849	64,240	62,136	58,606
Interest expense:				
Interest expense on repurchase agreements	59,016	58,680	56,854	47,147
Interest expense on junior subordinated notes	794	795	812	786
	59,810	59,475	57,666	47,933
Net interest income (loss)	4,039	4,765	4,470	10,673
(Loss) gain on sale of Agency MBS, Non-Agency MBS and derivatives Expenses	(1,578)	(1,500)	(23,594)	5
			(1,185)	(1,273)
Income (loss) from continuing operations	2,461	3,265	(20,309)	9,405
Income (loss) from discontinued operations	303	318	(136,728)	(15,181)
Net income (loss)	\$ 2,764	\$ 3,583	\$ (157,037)	\$ (5,776)
Dividend on Series A Cumulative Preferred Stock	\$	\$ (1,011)	\$ (1,011)	\$ (1,011)
Dividend on Series B Cumulative Convertible Preferred Stock	\$ (325)	\$ (449)	\$ (471)	\$ (471)
Net income (loss) to common stockholders	\$ 2,439	\$ 2,123	\$ (158,519)	\$ (7,258)
Basic and diluted net loss per common share:				
Continuing operations	\$ 0.04	\$ 0.04	\$ (0.47)	\$ 0.16
Discontinued operations	\$ 0.01	\$ 0.01	\$ (3.00)	\$ (0.31)
Total basic and diluted net income (loss) per common share	\$ 0.05	\$ 0.05	\$ (3.47)	\$ (0.15)
Basic diluted weighted average number of shares outstanding	45,614	45,640	45,640	48,937
Diluted weighted average number of shares outstanding	45,614	45,665	45,640	48,937

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

For the year ended December 31, 2006 (in thousands, except per share amounts):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income net of amortization of premium and discount:				
Interest on Agency MBS	\$ 46,220	\$ 46,704	\$ 55,295	\$ 57,535
Interest on Non-Agency MBS				532
	46,220	46,704	55,295	58,067
Interest expense:				
Interest expense on repurchase agreements	42,121	46,322	54,119	56,392
Interest expense on junior subordinated notes	690	742	788	864
	42,811	47,064	54,907	57,256
Net interest income (loss)	3,409	(360)	388	811
(Loss) on sale of Agency MBS and Non-Agency MBS Expenses	(1,351)	(1,213)	(1,482)	(1,436)
Income (loss) from continuing operations	2,058	(11,780)	(1,094)	(625)
Income (loss) from discontinued operations	309	(112)	(1,299)	(1,661)
Net income (loss)	\$ 2,367	\$ (11,892)	\$ (2,393)	\$ (2,286)
Dividend on Series A Cumulative Preferred Stock(1)	\$	\$ (1,011)	\$ (1,011)	\$ (2,022)
Net income (loss) to common stockholders	\$ 2,367	\$ (12,903)	\$ (3,404)	\$ (4,308)
Basic and diluted net loss per common share:				
Continuing operations	\$ 0.05	\$ (0.28)	\$ (0.04)	\$ (0.05)
Discontinued operations	\$	\$	\$ (0.03)	\$ (0.04)
Total basic and diluted net income (loss) per common share	\$ 0.05	\$ (0.28)	\$ (0.07)	\$ (0.09)
Basic diluted weighted average number of shares outstanding	45,388	45,372	45,392	45,565
Diluted weighted average number of shares outstanding	45,401	45,372	45,392	45,565

(1) The unaudited quarterly data has been corrected in accordance with SAB 108 (as described in Note 12) and will therefore not tie to the Form 10-Q that was filed.

NOTE 16. DISCONTINUED OPERATIONS

As described in Note 1 (Organization), we provided a description of the facts and circumstances that led up to the conclusion that all of the assets of Belvedere Trust were materially impaired and that it is reported as discontinued operations. In September 2007, we developed a plan to

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dispose of Belvedere Trust. The assets of Belvedere Trust have either been sold or written off. Belvedere Trust is neither acquiring any new assets nor transacting any new business and is in the process of dissolving its operations.

As described in Note 1 (Change in Basis of Presentation), we have concluded that Belvedere Trust and BT Management are reported as discontinued operations.

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Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The major assets and liabilities of the discontinued operations at December 31, 2007 and 2006 are as follows (in thousands):

	December 31, 2007	December 31, 2006
Assets of Discontinued Operations:		
BT Other MBS pledged to counterparties at fair value	\$	\$ 147,644
BT Other MBS at fair value		15,155
		162,799
Cash and cash equivalents		140
BT Residential Loans		1,682,522
Allowance for loan losses		(1,608)
Interest receivable		8,394
Other assets	38	6,542
	\$ 38	\$ 1,858,789
Liabilities of Discontinued Operations:		
Accrued interest payable	\$	\$ 8,487
Repurchase agreements (Belvedere Trust)(1)	7,713	275,733
MBS issued		1,471,724
Accrued expenses and other liabilities	121	116
	\$ 7,834	\$ 1,756,060

(1) For December 31, 2007, this represents three claims against Belvedere Trust related to its repurchase agreement transactions.

The major components of income and expense for the discontinued operations for the years ending December 31, 2007, 2006 and 2005 are as follows (in thousands):

	For the Year Ended December 31,		
	2007	2006	2005
Interest income:			
Interest on BT Other MBS	\$ 12,352	\$ 8,391	\$ 3,987
Interest on BT Residential Loans	54,360	94,682	118,518
	66,712	103,073	122,505
Interest expense:			
Interest expense on repurchase agreements	10,109	16,689	17,143
Interest expense on whole loan financing facilities		3	4,024
Interest expense on MBS issued	52,224	88,367	90,243

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	62,333	105,059	111,410
Net interest income (expense)	4,379	(1,986)	11,095
(Loss) gain on sale and impairment of Belvedere Trust s assets	(151,184)	2,622	129
Expenses	(4,483)	(3,399)	(4,614)
Net (loss) income from discontinued operations	\$ (151,288)	\$ (2,763)	\$ 6,610

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Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Accounting Policies and Footnotes for Discontinued Operations***BT Other MBS Portfolio*

At December 31, 2007, there were no assets remaining in Belvedere Trust's BT Other MBS portfolio. At December 31, 2006, the portfolio included high credit quality securities (which included both investment and non-investment grade MBS) which were previously backed by first-lien hybrid and adjustable-rate residential mortgage loans.

At December 31, 2006, we classified all of Belvedere Trust's BT Other MBS as available-for-sale. All assets that were classified as available-for-sale were carried at fair value and unrealized gains or losses were included in Other comprehensive income or loss as a component of stockholders' equity. Losses on securities classified as available-for-sale which were determined by management to be other-than-temporary in nature were reclassified from other comprehensive income to income.

Interest income on Belvedere Trust's BT Other MBS was determined in accordance with FASB Emerging Issues Task Force (EITF) 99-20. The excess of estimated future cash flows over the initial investment was the accretable yield to be recognized as interest income over the life of the investment using the effective yield method. If the current fair value of any individual security was lower than its current amortized cost, we determined whether an impairment charge was required to be taken through current income. If there was a continued adverse change in estimated cash flows (considering both the timing and the amount of the cash flows, and taking into consideration receipt of cash flows to date), then the security was written down to fair value, which then became the new amortized cost basis for future amortization.

Securities were recorded on the date the securities were purchased or sold. Realized gains or losses from securities transactions were determined based on the specific identified cost of the securities.

The following tables summarize Belvedere Trust's BT Other MBS classified as available-for-sale as of December 31, 2006, which were carried at their fair value (amounts in thousands):

December 31, 2006

	Total BT Other MBS
BT Other MBS	
Amortized cost	\$ 162,597
Unrealized gains	1,627
Unrealized losses	(1,425)
Fair value	\$ 162,799

Variable Interest Entities

As described in Note 1 (Change in Basis of Presentation), we determined that we are no longer the primary beneficiary of the variable interest entities and are no longer consolidating these interests. Previously, these interests had been shown under BT Residential Loans. Belvedere Trust structured securitization transactions primarily through non-qualified special purpose entities, or SPEs (such as real estate mortgage investment conduit, or REMIC, trusts). The principal business activity involved issuing various series of MBS (in the form of pass-through certificates or bonds collateralized by residential real estate loans). The collateral specific to each series of MBS was the sole source of repayment of the debt and, therefore, our exposure to loss was limited to

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

our net investment in the collateral. Under FASB Interpretation No. 46, or FIN 46, Consolidation of Variable Interest Entities, these interests in non-qualified SPEs were deemed to be VIEs and we were considered the primary beneficiary.

Residential Real Estate Loans and Allowance for Loan Losses

As previously described in Note 16 (Variable Interest Entities), Belvedere Trust is no longer considered the primary beneficiary. As of December 31, 2007, there were no residential real estate loans.

We formerly acquired residential mortgage loans and held them as long-term investments through Belvedere Trust. Belvedere Trust financed the mortgage loans with short-term debt until a sufficient quantity had been accumulated for securitization into MBS in order to obtain long-term financing and to enhance liquidity. Belvedere Trust's residential real estate loans were classified as held-for-investment and carried at their unpaid principal balance, adjusted for unamortized premiums or discounts. Interest income was accrued based upon the actual interest rates and the outstanding principal amounts on the loans. Premiums or discounts were amortized into income using the effective interest yield method, adjusted for actual prepayments and considering estimated future prepayments, based on SFAS 91.

Belvedere Trust maintained an allowance for loan losses for residential real estate loans held in consolidated securitization trusts and for loans held prior to securitization. The balance was included in Allowance for loan losses on the Consolidated Balance Sheets. Belvedere Trust established and maintained an allowance for estimated loan losses inherent in its BT Residential Loans portfolio. The loan loss reserves were based upon our assessment of various factors affecting the credit quality of its assets including, but not limited to, the characteristics of the loan portfolio, review of loan level data, borrowers' credit scores, delinquency and collateral value. The reserves were reviewed on a regular basis and adjusted as deemed necessary. The allowance for loan losses on residential real estate loans was established by taking loan loss provisions through our Consolidated Statements of Income.

At December 31, 2006, residential real estate loans consisted of the following (in thousands):

	Total Residential Real Estate Loans
Residential Real Estate Loans	
Principal balance	\$ 1,652,773
Principal receivable	11
Unamortized premium	30,788
Valuation reserve on real estate owned	(1,050)
Carrying value	\$ 1,682,522

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

At December 31, 2006, residential real estate loans consisted of the following (in thousands):

Loan Description	Interest Rate Type	Interest Rate		Maturity Date		Principal Balance	Delinquent Balance (30-59 Days)	Delinquent Balance (60+ Days)
First-lien adjustable-rate residential real estate loans	Moving Treasury Average ARM	6.750%	9.125%	2032	2045	\$ 657,311	\$ 14,542	\$ 5,982
First-lien adjustable-rate residential real estate loans	1-Month ARM	6.375%	9.000%	2034	2035	53,218	1,231	1,924
First-lien adjustable-rate residential real estate loans	6-Month ARM	6.000%	8.750%	2033	2035	102,288	5,268	6,176
First-lien adjustable-rate residential real estate loans	1-Year ARM	7.000%	7.625%	2033	2034	2,002		
First-lien adjustable-rate residential real estate loans	3-Year Hybrid	2.875%	6.375%	2033	2035	199,093	1,366	2,542
First-lien adjustable-rate residential real estate loans	5-Year Hybrid	3.375%	6.750%	2033	2035	472,935	3,962	3,875
First-lien adjustable-rate residential real estate loans	7-Year Hybrid	3.750%	6.625%	2033	2034	150,695	1,032	841
First-lien adjustable-rate residential real estate loans	10-Year Hybrid	4.500%	6.250%	2034	2035	15,231	314	
						\$ 1,652,773	\$ 27,715	\$ 21,340

At December 31, 2006, the residential real estate loans consisted of the following (in thousands):

Range of Principal Balance of Loans	December 31, 2006 Number of Loans	Principal Balance
\$0 \$99	171	\$ 13,533
\$100 \$149	494	61,728
\$150 \$199	490	85,137
\$200 \$249	424	95,051
\$250 \$299	337	92,584
\$300 \$349	390	127,726
\$350 \$399	536	201,699
\$400 \$449	422	179,016
\$450 \$499	329	156,018
\$500 \$749	697	411,234
\$750 \$999	159	139,116
\$1,000 or greater	73	89,931
	4,522	\$ 1,652,773

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At December 31, 2006, the weighted average gross coupon on residential real estate loans which Belvedere Trust securitized was 6.12% and the weighted average net coupon on residential real estate loans which Belvedere Trust securitized was 5.77%. At December 31, 2006, the weighted average FICO was 727 and the LTV was 72.

Geographic Concentration	December 31, 2006
Southern California	29%
Northern California	23
Florida	7
Colorado	4
Virginia	4
Michigan	3
Illinois	3
Nevada	3
Other states (none greater than 2%)	24
Total:	100%

The following table represents the changes at December 31, 2006 in Belvedere Trust's BT Residential Loans portfolio (in thousands):

	December 31, 2006
Balance, beginning of year	\$ 2,497,881
New loan acquisitions	
Sales (other than to consolidated securitization trusts)	(513)
Principal repayments	(797,871)
Premium amortization	(15,575)
Valuation reserve on real estate owned	(1,050)
Net activity on principal balance of real estate owned	(114)
Losses on real estate owned	(174)
Other adjustments	(62)
Balance, end of year	\$ 1,682,522

The following table represents the changes at December 31, 2006 in the allowance for loan losses on Belvedere Trust's BT Residential Loans portfolio (in thousands):

	December 31, 2006
Balance, beginning of period	\$ 1,655
Additions(1)	1,265
Valuation reserve on real estate owned	(1,050)
Charge-offs(1)	(304)

Recoveries(1)	42
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Balance, end of period	\$	1,608
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- (1) The allowance for loan losses was comprised of two components: a general loan loss reserve and a specific loan loss reserve. The general loan loss reserve was based upon our assessment of various factors affecting

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Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

the credit quality of Belvedere Trust's assets including, but not limited to, the characteristics of the loan portfolio, review of loan level data, borrowers' credit scores and collateral value. The specific loan loss reserve was determined based upon an analysis of individual seriously delinquent loans. During the twelve months ended December 31, 2006, Belvedere Trust added \$165 thousand to its general loan loss reserve and \$1.1 million to its specific loan loss reserve. During the twelve months ended December 31, 2006, credit losses of \$262 thousand (net of \$42 thousand in recoveries) were charged to Belvedere Trust's specific loan loss reserve.

Belvedere Trust's Repurchase Agreements

Belvedere Trust entered into repurchase agreements with major financial institutions to finance most of its BT Other MBS portfolio and to finance most of the retained portion of the residential real estate loans which it had securitized. The repurchase agreements were primarily short-term borrowings that were secured by the market value of the pledged assets and bear interest rates that have historically had their basis on LIBOR. At December 31, 2006, Belvedere Trust's repurchase agreements had a weighted average term to maturity of 124 days and a weighted average borrowing rate of 5.11%.

At December 31, 2006, Belvedere Trust's repurchase agreements had the following remaining maturities:

	December 31, 2006
Less than 3 months	66.0%
3 months to less than 1 year	19.5
1 year to less than 2 years	14.5
2 year to less than 3 years	
Total:	100.0%

At December 31, 2007, Belvedere Trust, which is reported as a discontinued operation, has three claims against it totaling approximately \$8 million, which have been contested, relating to repurchase agreement transactions. Anworth is neither a co-party to nor a guarantor of Belvedere Trust's repurchase agreements or any claims against Belvedere Trust.

MBS Issued and Whole Loan Financing Facilities

As discussed in Note 1 under "Change in Basis of Presentation," we are no longer consolidating Belvedere Trust's residential real estate loans and the related financing ("MBS issued").

Previously, Belvedere Trust financed its residential real estate loans using MBS issued (obligations due on pass-through certificates or bonds) through securitizations. The interest rates on the MBS issued were variable and were based either upon the interest rates on the underlying loan collateral or upon LIBOR. At December 31, 2006, the weighted average coupon on the MBS issued was 5.04%. The maturities on the MBS issued were also based upon the maturities of the underlying mortgages. Principal was paid on the MBS issued following receipt of principal payments on the loans. At December 31, 2006, residential real estate loans with a face value of approximately \$1.47 billion were pledged as collateral for the MBS issued.

Belvedere Trust entered into whole loan financing facilities to finance its residential real estate loan acquisitions prior to securitization. The whole loan financing facilities were short-term borrowings that were secured by the loans and bear interest rates that have historically had their basis on LIBOR. At December 31, 2007 and 2006, Belvedere Trust had no outstanding borrowings under these facilities.

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Fair Value of Financial Instruments*

Belvedere Trust's BT Other MBS portfolio was reflected in the consolidated financial statements at estimated fair value. Management based its fair value estimates for Belvedere Trust's BT Other MBS primarily on third-party bid price indications provided by dealers who make markets in these financial instruments when such indications are available. However, the fair value reported reflected estimates and were not necessarily indicative of the amounts that could be realized in a current market exchange.

Cash and cash equivalents, restricted cash, interest receivable, repurchase agreements and payables for securities purchased were reflected in the consolidated financial statements at their costs, which approximated fair value because of the nature and short term of these instruments.

The following table of the estimated fair value of financial instruments at December 31, 2006 was made by using available market information, historical data and appropriate valuation methodologies. However, considerable judgment is required to interpret market and historical data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts we could realize in a current market exchange.

The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

	December 31, 2006	
	Carrying Amount	Estimated Fair Value
	(in thousands)	
Residential real estate loans securitized	\$ 1,682,522	\$ 1,667,581
MBS issued	\$ 1,471,725	\$ 1,463,864

Residential real estate loans were presented on the Consolidated Balance Sheets at historical cost, net of amortization, as Belvedere Trust held these assets for investment. The fair value of the residential real estate loans was calculated using assumptions based on historical experience, industry information and estimated rates of future prepayments and credit losses. The estimates of fair value were inherently subjective in nature, involved matters of uncertainty and judgment and did not necessarily indicate the amounts that could be received in a current market exchange. The estimated fair value of MBS issued (obligations due on pass-through certificates) was based on dealers' quotes.

Capitalization of Securitization Costs

Belvedere Trust had capitalized various costs incurred in connection with securitization transactions. These costs were amortized into income over the expected lives of the securities using the proportional method, based on the effects of actual prepayments. When the loans and the related financing were deconsolidated, Belvedere Trust charged these capitalized costs against income during the third quarter of 2007.

NOTE 17. SUBSEQUENT EVENTS

Since December 31, 2007, we have entered into twelve additional swap agreements with an aggregate notional amount of \$740 million for terms of up to five years. We utilize swap agreements to manage interest rate risk. In accordance with these swap agreements, we pay a fixed rate of interest during the term of the swap agreements and receive a payment that varies with the three-month LIBOR rate.

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On January 25, 2008, we declared a Series A Preferred Stock dividend of \$0.539063 per share and a Series B Preferred Stock dividend of \$0.390625 per share, each of which is payable on April 15, 2008 to our holders of record of Series A Preferred Stock and Series B Preferred Stock, respectively, as of the close of business on March 31, 2008.

On January 30, 2008, we issued an aggregate of 16.445 million shares of common stock and received net proceeds of approximately \$136.5 million (net of underwriting fees, commissions and other costs). We used all of the net proceeds from this offering to acquire Agency MBS.

From January 2, 2008 through March 7, 2008, we sold 1.65 million shares of common stock under the Program with Cantor which provided net proceeds to us of approximately \$15.4 million. The sales agent received an aggregate of approximately \$394 thousand, which represents an average commission of approximately 2.5 % on the gross sales price per share.

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EXHIBIT INDEX

Exhibit	
Number	Description
3.1	Amended Articles of Incorporation of Anworth (incorporated by reference from our Registration Statement on Form S-11, Registration No. 333-38641, which became effective under the Securities Act of 1933 on March 12, 1998)
3.2	Articles of Amendment to Amended Articles of Incorporation (incorporated by reference from our Definitive Proxy Statement filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as filed with the SEC on May 14, 2003)
3.3	Articles Supplementary for Series A Cumulative Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on November 3, 2004)
3.4	Articles Supplementary for Series A Cumulative Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 21, 2005)
3.5	Articles Supplementary for Series B Cumulative Convertible Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 30, 2007)
3.6	Bylaws (incorporated by reference from our Registration Statement on Form S-11, Registration No. 333-38641, which became effective under the Securities Act of 1933 on March 12, 1998)
4.1	Specimen Common Stock Certificate (incorporated by reference from our Registration Statement on Form S-11, Registration No. 333-38641, which became effective under the Securities Act of 1933 on March 12, 1998)
4.2	Specimen Series A Cumulative Preferred Stock Certificate (incorporated by reference from our Current Report on Form 8-K filed with the SEC on November 3, 2004)
4.3	Specimen Series B Cumulative Convertible Preferred Stock Certificate (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 30, 2007)
4.4	Form of stock certificate evidencing Anworth Capital Trust I Floating Rate Preferred Securities (liquidation amount \$1,000 per Preferred Security) (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
4.5	Form of stock certificate evidencing Anworth Capital Trust I Floating Rate Common Securities (liquidation amount \$1,000 per Common Security) (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
4.6	Form of note evidencing the Anworth s Floating Rate Junior Subordinated Note Due 2035 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
4.7	Junior Subordinated Indenture dated as of March 15, 2005, between Anworth and JPMorgan Chase Bank (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
10.1*	2004 Equity Compensation Plan (incorporated by reference from our Definitive Proxy Statement filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as filed with the SEC on April 26, 2004)
10.2	2003 Dividend Reinvestment and Stock Purchase Plan (incorporated by reference from Post-Effective Amendment No. 1 to our Registration Statement on Form S-3, Registration No. 333-110744, which became effective under the Act on February 20, 2004)
10.3*	2002 Incentive Compensation Plan (incorporated by reference from our Definitive Proxy Statement filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as filed with the SEC on May 17, 2002)

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Number	Description
10.4	Agreement and Plan of Merger dated April 18, 2002 by and among Anworth, Anworth Mortgage Advisory Corporation (the Manager) and the stockholder of the Manager (incorporated by reference from our Definitive Proxy Statement filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as filed with the SEC on May 17, 2002)
10.5*	Employment Agreement dated January 1, 2002, between the Manager and Lloyd McAdams (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002)
10.6*	Employment Agreement dated January 1, 2002, between the Manager and Heather U. Baines (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002)
10.7*	Employment Agreement dated January 1, 2002, between the Manager and Joseph E. McAdams (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002)
10.8*	Addendum to Employment Agreement dated April 18, 2002, among Anworth, the Manager and Lloyd McAdams (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002)
10.9*	Addendum to Employment Agreement dated April 18, 2002, among Anworth, the Manager and Heather U. Baines (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002)
10.10*	Addendum to Employment Agreement dated April 18, 2002, among Anworth, the Manager and Joseph E. McAdams (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002)
10.11*	Second Addendum to Employment Agreement dated as of May 28, 2004 between Anworth and Lloyd McAdams (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2004, as filed with the SEC on August 9, 2004)
10.12*	Second Addendum to Employment Agreement dated as of June 13, 2002 between Anworth and Joseph E. McAdams (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002)
10.13*	Second Addendum to Employment Agreement dated as of June 27, 2006, between Anworth and Heather U. Baines (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)
10.14*	Third Addendum to Employment Agreement dated as of June 27, 2006, between Anworth and Lloyd McAdams (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)
10.15*	Third Addendum to Employment Agreement dated as of May 28, 2004, between Anworth and Joseph E. McAdams (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2004, as filed with the SEC on August 9, 2004)
10.16*	Fourth Addendum to Employment Agreement dated as of June 27, 2006, between Anworth and Joseph E. McAdams (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)
10.17	Sublease dated June 13, 2002, between Anworth and PIA (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002)
10.18	Amendment to Sublease dated July 8, 2003 between Anworth and PIA (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, as filed with the SEC on August 8, 2003)

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Number	Description
10.19	Administrative Agreement dated October 14, 2002, between Anworth and PIA (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, as filed with the SEC on November 14, 2002)
10.20	Deferred Compensation Plan (incorporated by reference from our Annual Report on Form 10-K for the year ended December 31, 2002, as filed with the SEC on March 26, 2003)
10.21	BT Management Operating Agreement dated November 3, 2003 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended September 30, 2003, as filed with the SEC on November 13, 2003)
10.22	Management Agreement dated November 3, 2003 between BT Management and Belvedere Trust Mortgage Corporation (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended September 30, 2003, as filed with the SEC on November 13, 2003)
10.23	Employment Agreement dated November 3, 2003 between BT Management and Claus Lund (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended September 30, 2003, as filed with the SEC on November 13, 2003)
10.24*	Employment Agreement dated November 3, 2003 between BT Management and Russell J. Thompson (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended September 30, 2003, as filed with the SEC on November 13, 2003)
10.25*	Purchase Agreement dated as of March 15, 2005, by and among Anworth, Anworth Capital Trust I, TABERNA Preferred Funding I, Ltd., and Merrill Lynch International (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
10.26	Amended and Restated Trust Agreement dated as of March 15, 2005, by and among Anworth, JPMorgan Chase Bank, National Association, Chase Bank USA, National Association, Lloyd McAdams, Joseph McAdams, Thad Brown and the several Holders, as defined therein (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
10.27	Assignment and Assumption of Sublease and Consent of Sublessor dated May 16, 2005 among Belvedere Trust, BT Management Holding Corporation and Keefe, Bruyette & Woods, Inc. (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2005, as filed with the SEC on August 9, 2005)
10.28	Guaranty of Sublease dated May 16, 2005 between Anworth and Keefe, Bruyette & Woods, Inc. (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2005, as filed with the SEC on August 9, 2005)
10.29	Second Amended and Restated Trust Agreement dated as of September 26, 2005 by and among Anworth, JPMorgan Chase Bank, National Association, Chase Bank USA, National Association, Lloyd McAdams, Joseph McAdams, Thad Brown and the several Holders, as defined therein. (incorporated by reference from our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, as filed with the SEC on March 16, 2006)
10.30*	Change in Control and Arbitration Agreement dated June 27, 2006, between Anworth and Thad M. Brown (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)
10.31*	Change in Control and Arbitration Agreement dated June 27, 2006, between Anworth and Charles J. Siegel (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)
10.32	Change in Control and Arbitration Agreement dated June 27, 2006, between Anworth and Evangelos Karagiannis (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)

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Number	Description
10.33*	Change in Control and Arbitration Agreement dated June 27, 2006, between Anworth and Bistra Pashamova (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2007)
10.34*	2007 Dividend Equivalent Rights Plan (incorporated by reference from our Definitive Proxy Statement filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as filed with the SEC on April 26, 2007)
10.35	Amended and Reinstated Sales Agreement dated June 29, 2007 between Anworth and Cantor Fitzgerald & Co. (incorporated by reference from our Current Report on Form 8-K filed with the SEC on July 2, 2007)
10.36*	Fifth Addendum to Employment Agreement dated as of February 13, 2008, between Anworth and Joseph E. McAdams (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 15, 2008)
10.37*	Third Addendum to Employment Agreement dated as of February 13, 2008, between Anworth and Heather U. Baines (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 15, 2008)
10.38*	Fourth Addendum to Employment Agreement dated as of February 22, 2008, between Anworth and Lloyd McAdams (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 27, 2008)
10.39*	Sixth Addendum to Employment Agreement dated as of February 22, 2008, between Anworth and Joseph E. McAdams (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 27, 2008)
12.1	Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends
14.1	Code of Ethics and Business Conduct (incorporated by reference from our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, as filed with the SEC on March 16, 2007)
21.1	List of Subsidiaries
23.1	Consent of BDO Seidman, LLP
31.1	Certification of the Principal Executive Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934
31.2	Certification of the Principal Financial Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934
32.1	Certifications of the Principal Executive Officer provided pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certifications of the Principal Financial Officer provided pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Represents a management contract or compensatory plan, contract or arrangement in which any director or any of the named executives participates.