

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended: December 31, 2020

OR

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

For the transition period from _____ to _____

Commission File Number: 001-08896

CAPSTEAD MORTGAGE CORPORATION

(Exact name of Registrant as specified in its Charter)

Maryland

(State or other jurisdiction of incorporation or organization)

8401 North Central Expressway, Suite 800, Dallas, TX

(Address of principal executive offices)

75-2027937

(I.R.S. Employer Identification No.)

75225-4404

(Zip Code)

Registrant's telephone number, including area code: (214) 874-2323

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

| Title of each class | Trading Symbols | Name of each exchange on which registered |
|---|-----------------|---|
| Common Stock (\$0.01 par value) | CMO | New York Stock Exchange |
| 7.50% Series E Cumulative Redeemable Preferred Stock (\$0.10 par value) | CMOPRE | New York Stock Exchange |

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

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 (1) has filed all documents and reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or other such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the Registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that Registrant was required to submit such files). YES NO

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

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

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

At June 30, 2020 the aggregate market value of the common stock held by nonaffiliates, based on the closing sale price of those shares on the New York Stock Exchange reported on June 30, 2020, was \$518,208,138

Number of shares of Common Stock outstanding at February 19, 2021: 96,782,617

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Registrant's definitive Proxy Statement, to be issued in connection with the 2021 Annual Meeting of Stockholders of the Registrant, are incorporated by reference into Part III.

CAPSTEAD MORTGAGE CORPORATION
2020 FORM 10-K ANNUAL REPORT
TABLE OF CONTENTS

PART I

| | <u>Page</u> |
|--|--------------------|
| ITEM 1. Business | 2 |
| ITEM 1A. Risk Factors | 5 |
| ITEM 1B. Unresolved Staff Comments | 12 |
| ITEM 2. Properties | 12 |
| ITEM 3. Legal Proceedings | 12 |
| ITEM 4. Mining Safety Disclosures | 12 |

PART II

| | |
|--|----|
| ITEM 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities | 13 |
| ITEM 6. Selected Financial Data | 14 |
| ITEM 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations | 15 |
| ITEM 7A. Quantitative and Qualitative Disclosures About Market Risks | 32 |
| ITEM 8. Financial Statements and Supplementary Data | 32 |
| ITEM 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure | 58 |
| ITEM 9A. Controls and Procedures | 58 |
| ITEM 9B. Other Information | 60 |

PART III

| | |
|---|----|
| ITEM 10. Directors, Executive Officers, and Corporate Governance | 60 |
| ITEM 11. Executive Compensation | 60 |
| ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters | 60 |
| ITEM 13. Certain Relationships and Related Transactions, and Director Independence | 60 |
| ITEM 14. Principal Accountant Fees and Services | 60 |

PART IV

| | |
|---|----|
| ITEM 15. Exhibits and Financial Statement Schedules | 61 |
| SIGNATURES | 63 |

PART I

ITEM 1. BUSINESS

Capstead Mortgage Corporation operates as a self-managed real estate investment trust (“REIT”) for federal income tax purposes and is based in Dallas, Texas. Unless the context otherwise indicates, Capstead Mortgage Corporation, together with its subsidiaries, is referred to as “Capstead” or the “Company.” Capstead was incorporated in the state of Maryland in 1985 and its common and Series E preferred stock are listed on the New York Stock Exchange under the symbols “CMO” and “CMOPRE,” respectively.

Capstead’s investment strategy involves managing and earning a financing spread on a leveraged portfolio of residential mortgage pass-through securities currently consisting primarily of adjustable-rate mortgage (“ARM”) securities issued and guaranteed by government-sponsored enterprises, either Fannie Mae or Freddie Mac, or by an agency of the federal government, Ginnie Mae. Together, these securities are referred to as “Agency Securities,” and are considered to have limited, if any, credit risk. This strategy differentiates Capstead from its peers because ARM loans underlying its investment portfolio can reset to more current interest rates within a relatively short period of time. This positions the Company to benefit from a potential recovery in financing spreads that typically contract during periods of rising interest rates and can result in smaller fluctuations in portfolio values compared to portfolios containing a significant amount of fixed-rate mortgage securities.

For further discussion of the Company’s business and financial condition, see Item 7 of this report, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” which is incorporated herein by reference.

Competition

As a residential mortgage REIT that focuses primarily on investing in ARM Agency Securities, Capstead competes for the acquisition of suitable investments with other mortgage REITs, commercial banks, insurance companies, and institutional investors such as private equity funds, mutual funds, pension funds and sovereign wealth funds. Many of these entities have lower yield requirements as well as greater financial resources and access to capital than the Company. Increased competition for the acquisition of Agency Securities can result in higher pricing levels for such assets. In addition, the availability of ARM Agency Securities for purchase in the secondary markets varies substantially with changes in market conditions and ARM origination levels, which have not kept pace with related runoff in recent years. Although higher pricing levels generally correspond to a higher book value per common share for the Company, higher prices paid for acquisitions can adversely affect portfolio yields and future profitability.

Regulation and Related Matters

Operating as an internally-managed REIT investing in Agency Securities subjects Capstead to various federal tax and regulatory requirements. For further discussion, see Item 1A of this report, “Risk Factors,” under the captions “Risks Related to Our Status as a REIT and Other Tax Matters” and “Risk Factors Related to Our Corporate Structure,” which is incorporated herein by reference.

Human Capital Resources

As of December 31, 2020, Capstead had 15 employees. The Company believes its employees are among its most important resources and are critical to its continued success. Employees are offered great flexibility to meet personal and family needs. The Company endeavors to maintain a workplace that is free from discrimination or harassment on the basis of color, race, sex, national origin, ethnicity, religion, age, disability, sexual orientation, gender identification or any other status protected by applicable law. The Company’s basis for hiring, development, training, compensation and advancement at the Company is qualifications, skills, performance and experience. The Company’s compensation program is designed to attract and retain talent and the Company continually assesses and strives to enhance employee satisfaction and engagement. The Company’s employees, many of whom have a long tenure with the Company, are offered regular opportunities to participate in professional development, continuing education, and tuition reimbursement programs.

Website Access to Company Reports and Other Company Information

Capstead makes available on its website at www.capstead.com, free of charge, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, investor presentations and press releases, including any amendments to such documents as soon as reasonably practicable after such materials are electronically filed or furnished to the Securities and Exchange Commission (“SEC”) or otherwise publicly released.

The Company makes available on its website charters for the committees of its Board of Directors, its Board of Directors’ Guidelines, its Amended and Restated Bylaws, its Code of Business Conduct and Ethics, its Financial Code of Professional Conduct and other information, including amendments to such documents and waivers, if any, to the codes. Such information will also be furnished, free of charge, upon written request to Capstead Mortgage Corporation, Attention: Stockholder Relations, 8401 North Central Expressway, Suite 800, Dallas, Texas 75225-4404.

Cautionary Statement Concerning Forward-Looking Statements

This document contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements, and may contain the words “believe,” “anticipate,” “expect,” “estimate,” “intend,” “will be,” “will likely continue,” “will likely result,” or words or phrases of similar meaning. Forward-looking statements are based largely on the expectations of management and are subject to a number of risks and uncertainties including, but not limited to, the following:

- fluctuations in interest rates and levels of mortgage prepayments;
- changes in market conditions as a result of federal corporate and individual income tax reform, federal government fiscal challenges and Federal Reserve monetary policy, including policy regarding its holdings of Agency and U.S. Treasury Securities;
- liquidity of secondary markets and credit markets, including the availability of financing at reasonable levels and terms to support investing on a leveraged basis;
- the impact of differing levels of leverage employed;
- changes in legislation or regulation affecting Agency Securities and similar federal government agencies and related guarantees;
- deterioration in credit quality and ratings of existing or future issuances of Agency Securities;
- the effectiveness of risk management strategies;
- the availability of suitable qualifying investments from both an investment return and regulatory perspective;
- the availability of new investment capital;
- our ability to maintain REIT status for U.S. federal income tax purposes;
- changes in legislation or regulation affecting exemptions for mortgage REITs from regulation under the Investment Company Act of 1940;
- negative impacts from the ongoing novel coronavirus (“COVID-19”) pandemic including on the U.S. or global economy or on our liquidity, financial condition and earnings;
- other changes in legislation or regulation affecting the mortgage and banking industries; and
- changes in general economic conditions, increases in costs and certain other factors.

In light of the ongoing COVID-19 pandemic, several of the risks and uncertainties described above are more likely to occur and/or the potential impact therefrom is harder to estimate. In particular, the impact of COVID-19 on fluctuations in interest rates and levels of mortgage prepayments, liquidity of secondary markets and credit markets, including the availability of financing at reasonable levels and terms to support investing on a leveraged basis, and changes in general economic conditions, are especially unclear at this time. Given this unprecedented uncertainty, actual results could differ materially from those anticipated or implied in the forward-looking statements included herein. In addition to the above considerations, actual results and liquidity are affected by other risks and uncertainties which could cause actual results to be significantly different from those expressed or implied by any forward-looking statements included herein. It is not possible to identify all of the risks, uncertainties and other factors that may affect future results. In light of these risks and uncertainties, the forward-looking events and circumstances discussed herein may not occur and actual results could differ materially from those anticipated or implied in the forward-looking statements. Forward-looking statements speak only as of the date the statement is made and the Company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Accordingly, readers of this document are cautioned not to place undue reliance on any forward-looking statements included herein.

ITEM 1A. RISK FACTORS

An investment in securities issued by us involves various risks. You should carefully consider the following risk factors in conjunction with the other information contained in this document before purchasing our securities. The risks discussed herein can adversely affect our business, liquidity, earnings, financial condition and future prospects, causing the market price of our securities to decline, which could cause you to lose all or part of an investment in our stock. The risk factors described below are not the only risks that may affect us. Additional risks and uncertainties not presently known to us also may adversely affect our business, liquidity, earnings and financial condition.

Risks Related to Our Business

Changes in interest rates, whether increases or decreases, may adversely affect our liquidity, financial condition and earnings. Our earnings depend primarily on the difference between the interest received on our residential mortgage investments and the interest paid on our secured borrowings, adjusted for the effects of derivative financial instruments held for hedging purposes. Our mortgage investments primarily consist of ARM Agency Securities that generally earn interest at longer-term rates than our borrowings. Only a portion of coupon interest rates on the ARM loans underlying our securities reset each month and the terms of these ARM loans generally limit the amount of any increases during any single interest rate adjustment period and over the life of a loan. Interest rates on our secured borrowings, which are heavily influenced by federal reserve actions to raise or lower the Fed Funds Rate, that are not effectively fixed through the use of interest rate swap agreements or similar derivatives can rise to levels that may exceed yields on our investments, including in a rising short-term interest rate environment or in an inverted yield curve environment. This can contribute to lower, or in more extreme circumstances, negative financing spreads and, therefore, adversely affect earnings. During periods of relatively low short term interest rates, declines in the indices used to determine coupon interest rate resets for ARM loans may adversely affect yields on our ARM securities as the underlying ARM loans reset at lower rates. If declines in these indices exceed declines in our borrowing rates, earnings would be adversely affected.

An increase in prepayments may adversely affect our liquidity, financial condition and earnings. Prepayment expectations are an essential part of pricing mortgage investments in the marketplace and the speed of prepayments can vary widely from month to month and across individual investments; however prolonged periods of high mortgage prepayments can significantly reduce the expected life of our portfolio. Therefore, actual yields we realize can be lower due to faster amortization of investment premiums, which can adversely affect earnings. High levels of mortgage prepayments can also lead to larger than anticipated demands on our liquidity from our lending counterparties. Additionally, periods of high prepayments can adversely affect pricing for most mortgage investments and, as a result, book value per common share can be adversely affected due to declines in the fair value of our remaining portfolio.

The lack of availability of suitable investments at attractive pricing may adversely affect our earnings. The pricing of investments is determined by a number of factors including interest rate levels and expectations, market liquidity conditions, and competition among investors for these investments, many of whom have greater financial resources and lower return requirements than us. We cannot assure investors that we will be able to acquire suitable investments at attractive pricing and in a timely manner to replace portfolio runoff as it occurs or to deploy new capital as it is raised. Neither can we assure investors that we will maintain the current composition of our investments, consisting primarily of ARM Agency Securities.

Monetary policy actions by the Federal Reserve could adversely affect our financial condition and earnings. The Federal Open Market Committee ("FOMC") assesses realized and expected economic conditions relative to its objectives in determining the timing and size of future adjustments to the target range of the Federal Funds Rate, to which our secured borrowings rates are closely related. We cannot

predict with certainty when and to what extent the FOMC may adjust the Federal Funds Rate. These actions could adversely affect our earnings and book value per common share.

Our strategy involves significant leverage, which could adversely affect our liquidity, financial condition and earnings. We expect our leverage to vary with market conditions and our assessment of the risk and return on our investments. This leverage creates significant risks to our liquidity, financial condition and earnings.

Periods of illiquidity in the mortgage markets may reduce amounts available under secured borrowing arrangements due to declines in the perceived value of related collateral and may reduce the number of counterparties willing to lend to us and/or the amounts individual counterparties are willing to lend, both of which could adversely impact our liquidity, financial condition and earnings. We finance our portfolio by pledging individual securities as collateral under uncommitted secured borrowing arrangements. If the perceived market value of the pledged collateral as determined by our lenders declines, we may be subject to margin calls wherein the lender requires us to pledge additional collateral to reestablish the agreed-upon margin percentage. Because market illiquidity tends to put downward pressure on asset prices, we may be presented with substantial margin calls during such periods. If we are unable or unwilling to pledge additional collateral, lenders can liquidate the collateral or seek other remedies, potentially under adverse market conditions, resulting in losses. At such times we may determine that it is prudent to sell assets to improve our ability to pledge sufficient collateral to support our remaining secured borrowings, which could result in losses. In addition, lower pricing levels for remaining investments will lead to declines in book value per common share.

Our ability to achieve our investment objectives depends on our ability to re-establish or roll maturing secured borrowings on a continuous basis and none of our counterparties are obligated to enter into new borrowing transactions at the conclusion of existing transactions. During periods of market illiquidity or due to perceived credit deterioration of the collateral pledged or of us, a lender may require that less favorable asset pricing procedures be employed, margin requirements be increased and/or may choose to limit or completely curtail lending to us. If a counterparty chooses not to roll a maturing borrowing, we must pay off the borrowing, generally with cash available from another secured borrowing arrangement entered into with another counterparty. If we determine that we do not have sufficient borrowing capacity with our remaining counterparties, we could be forced to sell assets under potentially adverse market conditions, which could result in losses. An industry-wide reduction in the availability of secured borrowings could adversely affect pricing levels for mortgage investments leading to declines in our liquidity and book value per common share. Under these conditions, we may determine that it is prudent to sell assets to improve our ability to pledge sufficient collateral to support our remaining borrowings, which could result in losses. In addition, lower pricing levels for remaining investments will lead to declines in book value per common share.

The COVID-19 pandemic and its economic impact may adversely affect our liquidity, financial condition and earnings. A novel coronavirus (“COVID-19”) pandemic continues to spread throughout the United States and the world. The pandemic has caused significant disruptions and pressure in financial markets. The Federal Reserve has taken a number of actions to support the financial system, including buying agency-guaranteed residential and commercial mortgage securities and reducing the Fed Funds rate by 150 basis points to zero to 25 basis points. These actions are broadly supportive to the mortgage markets, providing stability and lowering funding costs. However, there is no guarantee that the Federal Reserve’s attempts to mitigate the economic impact of COVID-19 will be successful in avoiding an adverse impact on our liquidity, financial condition and earnings.

The significant decrease in economic activity caused by the pandemic has had and may continue to have a significant adverse effect on the ability of mortgage borrowers to meet their obligations. These difficulties, along with the recent declines in interest rates, have led to higher rates of default, forbearance and refinancing resulting in higher prepayments, which have had an adverse impact on yields and could negatively affect the value of our assets. If these conditions continue or become worse, the negative effects on our liquidity, financial condition and earnings may become more severe.

Legislative and additional regulatory actions could adversely affect the availability and/or terms and conditions of secured borrowings and consequently, our liquidity, financial condition and earnings. The financial system is subject to changes in regulatory capital requirements and other leverage constraints. Any such changes may have a significant impact on the financial markets in general and on our strategy of holding a leveraged portfolio of mortgage investments. As a result, the availability and/or terms and conditions of secured borrowings could be adversely affected which could adversely affect our liquidity, earnings and book value per common share.

The replacement of LIBOR with an alternative reference rate may adversely affect our liquidity, financial condition and earnings. The Alternative Reference Rates Committee (“ARRC”) selected the Secured Overnight Financing Rate (“SOFR”), an index calculated by reference to short-term repurchase agreements backed by U.S. Treasury securities, as its preferred replacement for LIBOR. SOFR is an observed overnight rate, which differs from LIBOR, which is an estimated forward-looking rate and relies, to some degree, on the expert judgement of submitting panel members. Since SOFR is a secured rate backed by government securities, it does not take into account bank credit risk (as LIBOR does). ARRC has proposed a spread adjustment methodology to reflect and adjust for the historical differences between SOFR and LIBOR in order to make the spread-adjusted rates comparable in a fair and reasonable way. Most of our ARM portfolio, interest rate swap agreements and our unsecured borrowings use LIBOR as a benchmark interest rate and may need to transition to an alternative rate, likely based on SOFR. The transition from LIBOR to an alternative could result in financial market disruptions or significant changes in benchmark rates, adversely affecting our liquidity, financial condition and earnings.

We are highly dependent on information and communication systems. System failures, security breaches or cyber-attacks of networks or systems could significantly disrupt our business and adversely affect our financial condition and earnings. Our business is highly dependent on communications and information systems. Any failure or interruption of our systems or cyber-attacks or security breaches of our networks or systems could cause delays or other problems in our securities trading activities, which could adversely affect our business, financial condition and earnings. In addition, we also face the risk of operational failure, termination or capacity constraints of any of the third parties with which we do business or that facilitate our business activities, including clearing agents or other financial intermediaries we use to facilitate our securities transactions, if their respective systems experience failure, interruption, cyber-attacks, or security breaches. Computer malware, viruses, and computer hacking and phishing attacks have become more prevalent in the financial services industry and may occur on our systems in the future. We rely heavily on our financial, accounting and other data processing systems. Although we have not detected a breach to date, financial services institutions have reported breaches of their systems, some of which have been significant. Even with all reasonable security efforts, not every breach can be prevented or even detected. It is possible that we have experienced an undetected breach, and it is likely that other financial institutions have experienced more breaches than have been detected and reported. There is no assurance that we, or the third parties that facilitate our business activities, have not or will not experience a breach. It is difficult to determine what, if any, negative impact may directly result from any specific interruption or cyber-attacks or security breaches of our networks or systems (or the networks or systems of third parties that facilitate our business activities) or any failure to maintain performance, reliability and security of our technical infrastructure. However, such computer malware, viruses, computer hacking and phishing attacks could have a materially adverse effect on our business, financial condition and earnings.

Our use of borrowings under repurchase arrangements may expose us to losses if a lending counterparty seeks bankruptcy protection, or otherwise defaults on its obligation to deliver pledged collateral back to us. Repurchase arrangements involve the sale and transfer of pledged collateral to the lending counterparty and a simultaneous agreement to repurchase the transferred assets at a future date. This may make it difficult for us to recover our pledged assets if a lender files for bankruptcy or otherwise fails to deliver pledged collateral back to us and subject us to losses to the extent of any margin amounts (pledged assets in excess of amounts borrowed) held by the lending counterparty.

We invest in derivative financial instruments such as interest rate swap agreements to mitigate or hedge our interest rate risk, which may adversely affect our liquidity, financial condition and earnings. We invest in such instruments with the goal of partially offsetting changes in value of our investments as a result of changes in interest rates and achieving more stable borrowing costs over an extended period. However, these activities may not have the desired beneficial impact on our liquidity, financial condition or earnings. In addition, counterparties could fail to honor their commitments under the terms of the derivatives or have their credit quality downgraded impairing the value of the derivatives. In the event of any defaults by counterparties, the Company may have difficulty recovering its cash collateral receivable from its counterparties and may not receive payments provided for under the terms of the derivatives and as a result, the Company may incur losses.

We are dependent on our executives and employees and the loss of one or more of our executive officers could harm our business and prospects. We are dependent on the efforts of our key officers and employees, most of whom have significant experience in the mortgage industry. We have not acquired key man life insurance policies on any of these individuals. The loss of any of their services could have an adverse effect on our operations.

Our securities are recorded at fair value and quoted prices or observable inputs may not be readily available to determine the fair value. We measure fair value in accordance with generally accepted accounting standards. Ultimately, the value of any individual security depends to a large extent on economic and other conditions beyond our control. Our determination of the fair value of our investments includes inputs provided by third-party dealers and pricing services, which may be difficult to obtain or be unreliable. Fair value is an estimate based on good faith judgement of the price at which an investment can be sold. If we were to liquidate a particular investment, the realized value may be more than or less than the amount at which such is valued.

Any future offerings of preferred stock or debt securities, which would rank senior to our common stock upon liquidation, and future offerings of equity securities, which could dilute our existing stockholders and may be senior to our common stock for the purposes of dividend and liquidation distributions, may adversely affect the price of our common stock. We may raise capital through the issuance of debt or equity securities. Upon liquidation, holders of our debt securities, preferred stock and lenders with respect to our other borrowings will be entitled to our available assets prior to the holders of our common stock. Our preferred stock has a preference on liquidating distributions and dividend payments that could limit our ability to pay dividends to the holders of our common stock. Sales of substantial amounts of our common stock could have a material adverse effect on the price of our common stock. Because our decision to issue debt or equity 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 any future offerings.

Risks Related to Our Status as a REIT and Other Tax Matters

We may be subject to adverse legislative or regulatory tax changes that could reduce the market price of our securities. Federal income tax laws or the administrative interpretations of those laws can change at any time. Any such changes in laws or interpretations thereof may apply retroactively and could adversely affect us or our stockholders. We cannot predict any impact on the value of our securities from adverse legislative or regulatory tax changes.

If we do not qualify as a REIT, we will be subject to tax as a corporation and face substantial tax liability. We have elected to be taxed as a REIT for federal income tax purposes and intend to continue to so qualify. Qualification as a REIT involves the application of highly technical and complex Internal Revenue Code (“IRC”) provisions for which only a limited number of judicial or administrative interpretations exist. Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, new tax legislation, administrative guidance or court decisions, in each instance potentially with retroactive effect, 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 that we would be unable to deduct dividends paid to our stockholders in computing taxable income and would be subject to federal income tax on our taxable income at corporate rates, reducing cash available for distribution;
- we would not be required to make income distributions; and
- unless we were entitled to relief under applicable statutory provisions, we would be disqualified from treatment as a REIT for the subsequent four taxable years.

Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our earnings. We may be subject to certain federal, state and local taxes on our income and assets. For example, we:

- will be required to pay tax on any undistributed REIT taxable income; and
- may operate taxable REIT subsidiaries subject to tax on any taxable income earned.

Complying with REIT requirements may limit our ability to hedge effectively. The REIT provisions of the Code may limit our ability to hedge our investments and borrowings by limiting our income in each year from unqualified hedges, together with any other income not generated from qualified real estate assets, to no more than 25% of gross income. In addition, we must limit our aggregate income from nonqualified hedging transactions, from providing certain services, and from other non-qualifying sources to not more than 5% of annual gross income. As a result, we may have to limit our use of advantageous hedging techniques. This could result in greater risks associated with changes in interest rates than we would otherwise incur. If we were to fail to satisfy the REIT gross income tests we could lose our REIT status for federal income tax purposes unless the failure was due to reasonable cause and not due to willful neglect, in which case we may have to pay a penalty tax.

Complying with REIT requirements may cause us to forego otherwise attractive opportunities. To qualify as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts that we distribute to our stockholders, and the ownership of our stock. We may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution. As a result, compliance with the REIT requirements may hinder our ability to operate solely on the basis of maximizing profits.

Complying with REIT requirements may force us to liquidate otherwise attractive investments. To qualify as a REIT, we must also ensure that at the end of each calendar quarter at least 75% of the value of our assets consists of cash, cash items, United States government securities and qualified REIT real estate assets. The remainder of our investments in securities (other than government securities and qualified real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than government securities and qualified real estate assets) can consist of the securities of any one issuer, and no more than 20% of the value of our total securities can be represented by securities of one or more taxable REIT subsidiaries. If we fail to comply with these requirements at the end of any calendar quarter, we must correct such failure within 30 days after the end of the calendar quarter to avoid losing our REIT status and suffering adverse tax consequences. As a result, we may be required to liquidate otherwise attractive investments.

Complying with REIT requirements may force us to borrow to make distributions to our stockholders. As a REIT, we must distribute at least 90% of our annual taxable income (subject to certain adjustments) to our stockholders. To the extent that we satisfy the distribution requirement, but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our undistributed taxable income. In addition, we will be subject to a 4% nondeductible excise tax if the actual amount that we pay out to our stockholders in a calendar year is less than a minimum amount specified under the federal tax laws. From time to time, we may generate taxable income greater than our net income for financial

reporting purposes, our ability or the ability of our subsidiaries to deduct interest expense from borrowings may be limited under Section 163(j) of the Code or our taxable income may be greater than our cash flow available for distribution to stockholders. If we do not have other funds available in these situations, we could be required to borrow funds, sell investments at disadvantageous prices or find another alternative source of funds to make distributions sufficient to enable us to pay out enough of our taxable income to satisfy the distribution requirement and to avoid corporate income tax or the 4% excise tax in a particular year. These alternatives could increase our costs and reduce our long-term investment capital.

Distributions payable by us do not qualify for the reduced tax rates applicable to “qualified dividends.” The maximum tax rate applicable to income from non-REIT corporate qualified dividends payable to domestic stockholders that are individuals, trusts or estates is currently 20%. Distributions of ordinary income payable by REITs, however, generally are not eligible for the reduced rates. For taxable years beginning before January 1, 2026, non-corporate taxpayers may deduct up to 20% of certain pass-through business income, including “qualified REIT dividends” (generally, dividends received by a REIT stockholder that are not designated as returns of capital, capital gain or qualified dividend income), subject to certain limitations, resulting in an effective maximum U.S. federal income tax rate of 29.6% on such income. The more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts or 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 REIT stocks.

We may in the future choose to pay dividends in our own stock, in which case stockholders may be required to pay tax in excess of the cash they receive. A publicly traded REIT generally may treat a distribution of its own stock as fulfilling its REIT distribution requirement if each stockholder is permitted to elect to receive its distribution in either cash or stock of the REIT (even where there is a limitation on the percentage of the distribution payable in cash, provided that the limitation is at least 20%), subject to the satisfaction of certain guidelines. If the requirements are met, for U.S. federal income tax purposes, the amount of the distribution paid in stock generally will be a taxable distribution in an amount equal to the amount of cash that could have been received instead of stock. Taxable stockholders receiving such dividends would be required to include the full amount of the dividend as ordinary income (or as long-term capital gain to the extent such distribution is properly designated as a capital gain dividend) to the extent of our current and accumulated earnings and profits for federal income tax purposes. As a result, a U.S. stockholder may be required to pay tax with respect to such dividends in excess of any cash received. Furthermore, with respect to Non-U.S. stockholders, we may be required to withhold U.S. tax with respect to such dividends, including all or a portion of such dividend that is payable in stock. It is uncertain whether and to what extent we will pay dividends in cash and our stock.

Our ownership of and relationship with our TRS will be limited, and a failure to comply with the limits would jeopardize our REIT status and may result in the application of a 100% excise tax. A REIT may own up to 100% of the stock of one or more TRSs. A TRS may earn income that would not be qualifying income if earned directly by the parent REIT. Overall, no more than 20% of the value of a REIT's total assets may consist of stock or securities of one or more TRSs. A domestic TRS will pay federal, state and local income tax at regular corporate rates on any income that it earns. In addition, the TRS rules limit the deductibility of interest paid or accrued by TRS to its parent REIT to assure that the TRS is subject to an appropriate level of corporate taxation, and in certain circumstances, the ability of our TRSs to deduct net business interest expenses generally may be limited. The rules also impose a 100% excise tax on certain transactions between a TRS and its parent REIT that are not conducted on an arm's-length basis.

Risk Factors Related to Our Corporate Structure

There are no assurances of our ability to pay dividends in the future. We intend to continue paying quarterly dividends and to make distributions to our 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 IRC. However,

our ability to pay dividends may be adversely affected by the risk factors described in this filing. All distributions will be made at the discretion of our Board of Directors and will depend upon our earnings, financial condition, maintenance of our REIT status and such other factors as the board may deem relevant from time to time. There are no assurances of our ability to pay dividends in the future.

Failure to maintain an exemption from the Investment Company Act of 1940 would adversely affect our results of operations. The Investment Company Act of 1940 (the “40 Act”) exempts from regulation as an investment company any entity that is primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on, and interests in, real estate. For over 30 years, the staff of the SEC has interpreted the provisions of the 40 Act to require, among other things, a REIT to maintain at least 55% of its assets directly in qualifying real estate interests and at least 80% of its assets in real estate-related assets in order to be exempt from regulation as an investment company. Critical to our exemption from regulation as an investment company is the long-standing SEC staff interpretation that so-called whole loan mortgage securities, in which an investor holds all issued certificates with respect to an underlying pool of mortgage loans, constitute qualifying real estate interests for purposes of the staff’s 55% qualifying real estate interest requirement. Conversely, so-called partial pool mortgage securities presently do not qualify for purposes of meeting the 55% requirement, although they are considered by the staff to be real estate-related assets for purposes of meeting the staff’s 80% real estate-related asset requirement.

If the SEC or its staff adopts contrary interpretations of the 40 Act and we and other similar REITs become subject to regulation as investment companies, the industry’s use of leverage would be substantially reduced. Absent a restructuring of our business operations to avoid such regulation, this could require the sale of most of our investments under potentially adverse market conditions resulting in losses and significantly reduce future net interest margins and earnings.

Pursuant to our charter, our Board of Directors has the ability to limit ownership of our capital stock, to the extent necessary to preserve our REIT qualification. For the purpose of preserving our REIT qualification, our charter gives the board the ability to repurchase outstanding shares of capital stock from existing stockholders if the board determines in good faith that the concentration of ownership by such individuals, directly or indirectly, would cause us to fail to qualify as a REIT. Constructive ownership rules are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed constructively owned by one individual or entity. As a result, the acquisition of outstanding stock by an individual or entity could cause that individual or entity to own constructively a greater concentration of our outstanding stock than is acceptable for REIT purposes, thereby giving the board the ability to repurchase any excess shares.

Because provisions contained in Maryland law and our charter may have an anti-takeover effect, investors may be prevented from receiving a “control premium” for their shares. Provisions contained in our charter and Maryland general corporation law can 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 stock or purchases of large blocks of our common stock, thereby limiting the opportunities for our stockholders to receive a premium over then-prevailing market prices. These provisions include the following:

- *Repurchase rights* – Repurchase rights granted to our board in our charter limit related investors, including, among other things, any voting group, from owning common stock if the concentration owned would jeopardize our REIT status.
- *Classification of preferred stock* – Our charter authorizes the board to issue preferred stock and establish the preferences and rights of any class of preferred stock issued. These actions can be taken without soliciting stockholder approval and could have the effect of delaying or preventing someone from taking control of us.
- *Statutory provisions* – We are subject to provisions of Maryland statutory law that restrict business combinations with interested stockholders and restrict voting rights of certain shares

acquired in control share acquisitions. The board has not taken any action to exempt us from these provisions.

- *Other Maryland law elections* – A provision of Maryland law allows our board, without stockholder approval, to implement various provisions that may deter stockholder efforts to change the composition of our Board of Directors by, among other things, implementing a staggered board, providing that directors are removable only for cause, requiring that a majority of the outstanding shares request a special meeting of stockholders, and providing directors the exclusive right to fill vacancies on the board. Our board has not taken any action to limit its ability to implement any of these provisions in the future, other than to provide, through an unrelated provision of Maryland law, that imposes a majority requirement for the calling of a special meeting of stockholders.

Maryland statutory law provides that an act of a director relating to or affecting an acquisition or a potential acquisition of control of a corporation may not be subject to a higher duty or greater scrutiny than is applied to any other act of a director. Hence, directors of Maryland corporations may not be required to act in takeover situations under the same standards as apply in Delaware and certain other corporate jurisdictions.

We may change our policies without stockholder approval. Our board and management determine all of our policies, including our investment, financing and distribution policies and may amend or revise these policies at any time without a vote of our stockholders. Policy changes could adversely affect our financial condition, results of operations, the market price of our common and preferred stock or our ability to pay dividends or distributions.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Capstead's headquarters are located in Dallas, Texas in office space leased by the Company.

ITEM 3. LEGAL PROCEEDINGS

None.

ITEM 4. MINING SAFETY DISCLOSURES

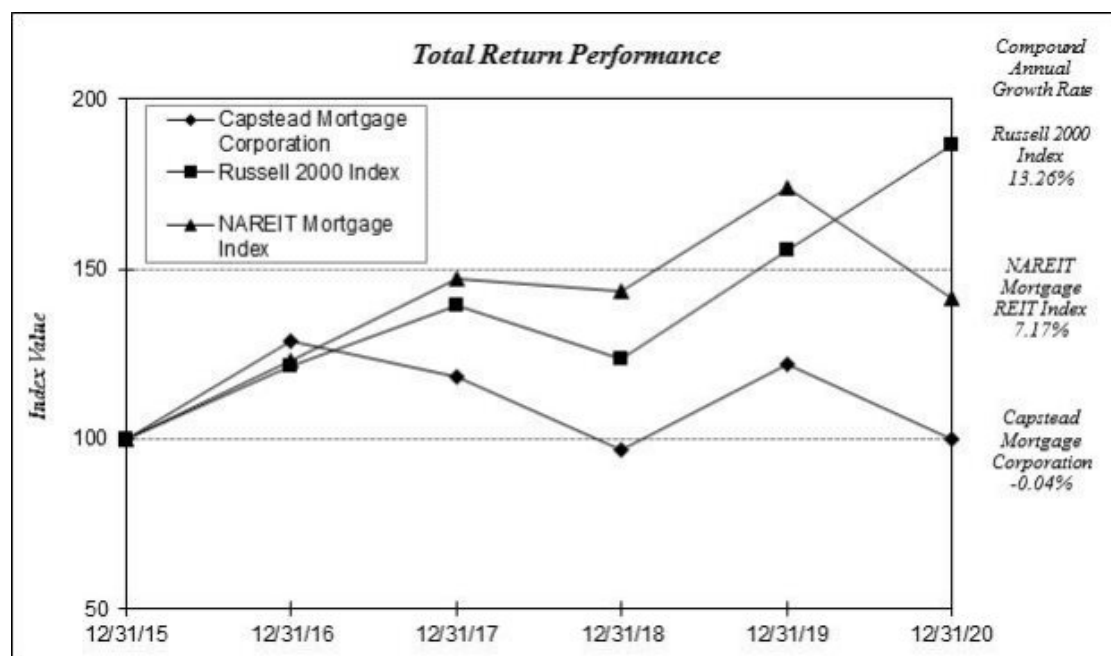
Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The New York Stock Exchange trading symbol for Capstead's common stock is CMO. As of February 11, 2021, the Company had 910 common stockholders of record and depository companies held shares of common stock for approximately 20,426 beneficial owners.

Set forth below is a graph comparing the yearly percentage change in the cumulative total return on Capstead's common stock, with the yearly percentage change in the cumulative total return on the Russell 2000 Index and the NAREIT Mortgage REIT Index for the five years ended December 31, 2020 assuming the investment of \$100 on December 31, 2015 and the reinvestment of dividends. The stock price and dividend performance reflected in the graph is not necessarily indicative of future performance.



| | <i>Year ended December 31</i> | | | | | |
|-------------------------------|-------------------------------|-------------|-------------|-------------|-------------|-------------|
| | <i>2015</i> | <i>2016</i> | <i>2017</i> | <i>2018</i> | <i>2019</i> | <i>2020</i> |
| Capstead Mortgage Corporation | \$ 100.00 | \$ 128.53 | \$ 118.28 | \$ 96.84 | \$ 121.93 | \$ 99.78 |
| Russell 2000 Index | 100.00 | 121.31 | 139.08 | 123.76 | 155.35 | 186.36 |
| NAREIT Mortgage REIT Index | 100.00 | 122.85 | 147.16 | 143.45 | 174.05 | 141.38 |

The Company did not repurchase any shares during the fourth quarter of 2020. The timing, manner, price and amount of any future common and preferred issuances and any common stock repurchases will be made in the open market at the Company's discretion, subject to economic and market conditions, stock price, compliance with federal securities laws and tax regulations as well as blackout periods associated with the dissemination of important Company-specific news.

See Item 12 of this report, "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters," for information regarding securities authorized for issuance under equity compensation plans which is incorporated herein by reference. Capstead did not issue any unregistered securities during the past three fiscal years.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

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

This section of this Annual Report on Form 10-K generally discusses 2020 and 2019 items and year-to-year comparisons between 2020 and 2019. Discussions of 2018 items and year-to-year comparisons between 2019 and 2018 that are not included in this Annual Report can be found in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II, Item 7 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2019.

Overview

Capstead operates as a self-managed REIT earning income from investing in a leveraged portfolio of residential mortgage pass-through securities primarily consisting of relatively short-duration ARM Agency Securities, which reset to more current interest rates within a relatively short period of time and are considered to have limited, if any, credit risk. By investing primarily in ARM Agency Securities, the Company is positioned to benefit from future recoveries in financing spreads that typically contract during periods of rising interest rates and to experience smaller fluctuations in portfolio values compared to leveraged portfolios containing a significant amount of fixed-rate mortgage securities.

Capstead reported for GAAP purposes a net loss of \$130 million or \$(1.56) per diluted common share in 2020, compared to a 2019 net loss of \$35 million or \$(0.62) per diluted common share. The Company reported core earnings of \$81 million or \$0.64 per diluted common share for the year ended December 31, 2020, compared to 2019 core earnings of \$64 million or \$0.50 per diluted common share. See "Reconciliation of GAAP and non-GAAP Financial Measures" for more information on core earnings.

The GAAP net loss in 2020 includes \$160 million in losses on hedging-related derivatives primarily related to declining interest rates and \$68 million in losses on the sale of \$2.62 billion (basis) in ARM securities late in the first quarter. These sales, together with not fully replacing portfolio runoff during the year helped ensure the Company had sufficient flexibility to meet projected liquidity requirements while maintaining portfolio leverage at comfortable levels given disruptions experienced in the fixed income markets brought on by the COVID-19 pandemic.

Both GAAP and core earnings in 2020 were positively impacted by lower secured borrowings rates primarily due to a total of 150 basis points in reductions in the Fed Funds rate in March and favorable terms on new interest rate swap agreements entered into throughout the year. However, historically low interest rates have led to exceedingly high prepayment speeds across all mortgage products which negatively impacted both GAAP and core earnings in 2020. The Company expects prepayment speeds will remain elevated in 2021.

Capstead finances its residential mortgage investments by leveraging its long-term investment capital with secured borrowings consisting primarily of borrowings under repurchase arrangements with commercial banks and other financial institutions. Long-term investment capital totaled \$1.01 billion at December 31, 2020, consisting of \$659 million of common and \$251 million of preferred stockholders' equity together with \$98 million of unsecured borrowings maturing in 2035 and 2036.

Capstead's residential mortgage investments decreased \$3.28 billion to \$7.94 billion at December 31, 2020. Secured borrowings decreased \$2.96 billion to \$7.32 billion as a result of lower portfolio balances. Portfolio leverage (secured borrowings divided by long-term investment capital) decreased to 7.26 to one at December 31, 2020 from 8.77 to one at December 31, 2019. Management continuously evaluates portfolio leverage levels in light of changes to market conditions.

COVID-19 Pandemic

An unprecedented, near-total shutdown of the U.S. economy beginning in March due to the COVID-19 pandemic heightened fears of extremely high credit default levels and recession, leading to de-risking occurring at all levels of the fixed income markets. Credit asset pricing came under severe pressure destabilizing fixed income markets and leading to lender margin calls, feeding additional selling as levered and even unlevered investors across the spectrum were forced to sell their most liquid positions to raise cash to meet additional margin calls and/or fund redemptions. Investors were already coming under stress due to declining Treasury rates which led to losses on derivatives held for hedging purposes and variation (valuation-based) margin calls. As the crisis deepened this additional drain on liquidity became more pronounced and included increased initial (base haircut) margin requirements for derivatives due to heightened market volatility. The result was sharply falling asset prices even as market interest rates declined. During this period of extreme volatility, the Company sold a portion of its portfolio late in March and reduced its swap positions in order to ensure it had sufficient flexibility to meet future projected liquidity requirements while maintaining portfolio leverage at comfortable levels.

Intervention by the Federal Reserve beginning in late March in the form of the buying of fixed-rate Agency Securities helped stabilize this key market sector leading to improved pricing levels for fixed-rate Agency Securities. While the Federal Reserve has not purchased ARM Agency Securities specifically, these actions contributed to improved pricing levels for mortgage assets in general and a more stable operating environment for Capstead.

The Company met all of its funding requirements during the year. At December 31, 2020, the Company's potential liquidity was \$524 million and it believes it has ample access to necessary financing through its existing lending counterparties to meet its liquidity needs. See "Utilization of Long-term Investment Capital and Potential Liquidity" for further discussion.

The Company continues to operate portions of its business continuity plan in response to the pandemic and has not experienced any operational disruption due to its small number of employees who are all able to work remotely. Management will continue to closely monitor the situation and adapt its response as necessary to avoid any operational disruptions.

Common Equity Issuances

During February 2020, Capstead issued 1.6 million shares of common stock through an at-the-market continuous offering program at an average issue price of \$8.21, net of fees and other costs, for net proceeds of \$12.9 million. During 2019 the Company completed a public offering for nine million shares of common stock raising \$75 million for a net price of \$8.34 after underwriting discounts and offering expenses. Additional amounts of equity capital may be raised in the future under continuous offering programs or by other means, subject to market conditions, compliance with federal securities laws and blackout periods.

Book Value per Common Share

Book value per common share (total stockholder's equity, less liquidation preferences for outstanding shares of preferred stock, divided by outstanding shares of common stock) as of December 31, 2020 was \$6.76, a decrease of \$1.86 or 21.6% from December 31, 2019 book value of \$8.62, primarily reflecting \$1.60 in derivative-related declines in value along with \$0.70 of declines related to the \$2.62 billion of portfolio sales late in the first quarter. These declines were partially offset by \$0.41 in portfolio valuation-related increases.

All of Capstead's residential mortgage investments portfolio and its derivatives are recorded at fair value on the Company's balance sheet and are therefore included in the calculation of book value per share of common stock. None of the Company's borrowings are recorded at fair value. Fair value is impacted by

market conditions, including changes in interest rates, and the availability of financing at reasonable rates and leverage levels, among other factors. See NOTE 8 to the Consolidated Financial Statements for additional disclosures regarding fair values of financial instruments held or issued by the Company.

Residential Mortgage Investments

The following table illustrates the progression of Capstead's portfolio of residential mortgage investments for the indicated periods (in thousands):

| | <i>As of and for the year ended December 31</i> | | |
|---|---|----------------------|-----------------------|
| | <i>2020</i> | <i>2019</i> | <i>2018</i> |
| Residential mortgage investments, beginning of year | \$ 11,220,630 | \$ 11,962,948 | \$ 13,450,793 |
| Portfolio acquisitions (principal amount) | 3,061,142 | 3,239,372 | 2,251,425 |
| Investment premiums on acquisitions | 112,200 | 76,788 | 51,231 |
| Portfolio runoff (principal amount) | (3,797,847) | (3,751,895) | (3,602,678) |
| Sales of investments (cost basis) | (2,620,297) | (305,356) | – |
| Investment premium amortization | (77,560) | (73,740) | (115,333) |
| Change in net unrealized gains on securities classified as available-for-sale | 39,284 | 72,513 | (72,490) |
| Residential mortgage investments, end of year | <u>\$ 7,937,552</u> | <u>\$ 11,220,630</u> | <u>\$ 11,962,948</u> |
| Decrease in residential mortgage investments | <u>\$ (3,283,078)</u> | <u>\$ (742,318)</u> | <u>\$ (1,487,845)</u> |

Capstead's investment strategy focuses on managing a portfolio of residential mortgage investments primarily consisting of ARM Agency Securities. Agency Securities are considered to have limited, if any, credit risk because the timely payment of principal and interest is guaranteed by Fannie Mae and Freddie Mac, which are government-sponsored enterprises, or Ginnie Mae, which is an agency of the federal government. Federal government support for Fannie Mae and Freddie Mac has largely alleviated market concerns regarding the ability of Fannie Mae and Freddie Mac to fulfill their guarantee obligations.

By focusing primarily on investing in ARM Agency Securities, changes in fair value caused by changes in interest rates are typically relatively modest compared to changes in fair value of longer-duration fixed-rate assets. Declines in fair value caused by increases in interest rates are generally recoverable in a relatively short period of time as coupon interest rates on the underlying mortgage loans reset to rates more reflective of the then-current interest rate environment. This investment strategy positions the Company to benefit from potential recoveries in financing spreads that typically contract during periods of rising interest rates.

Capstead classifies its ARM securities based on the average length of time until the loans underlying each security reset to more current rates (“months-to-roll”) (less than 18 months for “current-reset” ARM securities, and 18 months or greater for “longer-to-reset” ARM securities). The Company’s ARM holdings featured the following characteristics at December 31, 2020 (dollars in thousands):

| <i>ARM Type</i> | <i>Amortized Cost Basis (a)</i> | <i>Net WAC (b)</i> | <i>Fully Indexed WAC (b)</i> | <i>Average Net Margins (b)</i> | <i>Average Periodic Caps (b)</i> | <i>Average Lifetime Caps (b)</i> | <i>Months To Roll</i> |
|--|---------------------------------|--------------------|------------------------------|--------------------------------|----------------------------------|----------------------------------|-----------------------|
| Current-reset ARMs: | | | | | | | |
| Fannie Mae Agency Securities | \$ 2,034,759 | 2.48% | 1.98% | 1.65% | 2.84% | 6.92% | 5.9 |
| Freddie Mac Agency Securities | 653,411 | 2.72 | 2.07 | 1.77 | 2.22 | 6.08 | 7.6 |
| Ginnie Mae Agency Securities | 169,632 | 2.70 | 1.62 | 1.51 | 1.09 | 5.80 | 6.3 |
| (36% of total) | <u>2,857,802</u> | 2.55 | 1.98 | 1.67 | 2.59 | 6.66 | 6.3 |
| Longer-to-reset ARMs: | | | | | | | |
| Fannie Mae Agency Securities | 2,462,143 | 2.86 | 1.95 | 1.60 | 4.24 | 5.03 | 54.8 |
| Freddie Mac Agency Securities | 2,085,258 | 2.62 | 1.99 | 1.65 | 4.19 | 5.03 | 61.7 |
| Ginnie Mae Agency Securities | 447,798 | 3.65 | 1.60 | 1.50 | 1.00 | 5.00 | 38.6 |
| (64% of total) | <u>4,995,199</u> | 2.83 | 1.93 | 1.61 | 3.93 | 5.03 | 56.2 |
| | <u>\$ 7,853,001</u> | 2.73 | 1.95 | 1.63 | 3.44 | 5.62 | 38.1 |
| Gross WAC (rate paid by borrowers) (c) | | 3.36 | | | | | |

(a) Amortized cost basis represents the Company’s investment (unpaid principal balance plus unamortized investment premiums) before unrealized gains and losses. At December 31, 2020, the ratio of amortized cost basis to unpaid principal balance for the Company’s ARM holdings was 103.57.

(b) Net WAC, or weighted average coupon, is the weighted average interest rate of the mortgage loans underlying the indicated investments, net of servicing and other fees as of the indicated date. Net WAC is expressed as a percentage calculated on an annualized basis on the unpaid principal balances of the mortgage loans underlying these investments. As such, it is similar to the cash yield on the portfolio which is calculated using amortized cost basis. Fully indexed WAC represents the weighted average coupon upon one or more resets using interest rate indexes and net margins as of the indicated date. Average net margins represent the weighted average levels over the underlying indexes that the portfolio can adjust to upon reset, usually subject to initial, periodic and/or lifetime caps on the amount of such adjustments during any single interest rate adjustment period and over the contractual term of the underlying loans.

ARM securities with initial fixed-rate periods of five years or longer typically have either 200 or 500 basis point initial caps with 200 basis point periodic caps. Additionally, certain ARM securities held by the Company are subject only to lifetime caps or are not subject to a cap. For presentation purposes, average periodic caps in the table above reflect initial caps until after an ARM security has reached its initial reset date and lifetime caps, less the current net WAC, for ARM securities subject only to lifetime caps. At year-end, 74% of current-reset ARM securities were subject to periodic caps averaging 1.90%; 18% were subject to initial caps averaging 3.04%; 8% were subject to lifetime caps averaging 7.67%. All longer-to-reset ARM securities at December 31, 2020 were subject to initial caps.

(c) Gross WAC is the weighted average interest rate of the mortgage loans underlying the indicated investments, including servicing and other fees paid by borrowers, as of the indicated date.

ARM securities held by Capstead are backed by mortgage loans that have coupon interest rates that adjust at least annually to more current interest rates or begin doing so after an initial fixed-rate period. These coupon interest rate adjustments are usually subject to periodic and lifetime limits, or caps, on the amount of such adjustments during any single interest rate adjustment period and over the contractual term of the underlying loans. After the initial fixed-rate period, if applicable, the coupon interest rates of mortgage loans underlying the Company’s ARM securities typically adjust either (a) annually based on specified margins over the one-year London interbank offered rate (“LIBOR”) or the one-year Constant Maturity U.S. Treasury Note Rate (“CMT”), (b) semiannually based on specified margins over six-month LIBOR, or (c) monthly based on specified margins over indices such as one-month LIBOR, the Eleventh District Federal Reserve Bank Cost of Funds Index, or over a rolling twelve month average of the one-year CMT index. Fannie Mae and Freddie Mac began accepting ARM loans based on the Secured Overnight Financing Rate (“SOFR”) in August 2020 and stopped accepting LIBOR-based ARM loans after December 2020 due to the scheduled discontinuation of LIBOR in December 2021. The Company expects to continue investing in Agency ARM Securities backed by a variety of indices including new SOFR-based ARM securities.

Approximately 22% of the Company's current-reset ARM securities are scheduled to reset in rate within three months, 33% are scheduled to reset in rate between four and six months, and 40% are scheduled to reset in rate between seven and 12 months. Approximately 18%, or \$490 million of the Company's current-reset ARM securities with average net WACs of 2.72% and fully-indexed WACs of 1.97% will reset in rate for the first time in less than 18 months based on indices in effect at December 31, 2020. After consideration of any applicable initial fixed-rate periods, at December 31, 2020 approximately 90%, 5% and 3% of the Company's ARM securities were backed by mortgage loans that reset annually, semi-annually and monthly, respectively, while approximately 2% reset every five years. At December 31, 2020 approximately 2% of the Company's portfolio was backed by interest-only loans, with remaining interest-only payment periods averaging 11 months. All percentages are based on averages of the characteristics of mortgage loans underlying each security and calculated using unpaid principal balances as of the indicated date.

Secured Borrowings and Related Derivatives

Capstead finances its residential mortgage investments by leveraging its long-term investment capital primarily with borrowings under repurchase arrangements with commercial banks and other financial institutions. The Company maintains the beneficial interest in the specific securities pledged during the term of each repurchase arrangement and receives the related principal and interest payments.

The terms and conditions of secured borrowings are negotiated on a transaction-by-transaction basis when each such borrowing is initiated or renewed. None of the Company's counterparties are obligated to renew or otherwise enter into new borrowings at the conclusion of existing borrowings. Collateral requirements in excess of amounts borrowed (referred to as "haircuts") averaged 4.4 percent of the fair value of pledged residential mortgage pass-through securities at December 31, 2020. After considering haircuts and related interest receivable on the collateral, as well as interest payable on these borrowings, the Company had \$410 million of capital at risk with its lending counterparties at December 31, 2020. The Company did not have capital at risk with any single counterparty exceeding 6% of total stockholders' equity at December 31, 2020.

Secured borrowing rates are generally fixed based on prevailing rates corresponding to the terms of the borrowings. Interest may be paid monthly or at the termination of a borrowing at which time the Company may enter into a new borrowing at prevailing haircuts and rates with the same counterparty or repay that counterparty and negotiate financing with a different counterparty. When the fair value of pledged securities declines due to changes in market conditions or the publishing of monthly security pay-down factors, lenders typically require the Company to post additional securities as collateral, pay down borrowings or fund cash margin accounts with the counterparties in order to re-establish the agreed-upon collateral requirements, referred to as margin calls. Conversely, if collateral fair values increase, lenders are required to release collateral back to the Company pursuant to Company-issued margin calls.

As of December 31, 2020, the Company's secured borrowings totaled \$7.32 billion with 19 counterparties at average rates of 0.21%, before the effects of currently-paying interest rate swap agreements. The Company typically uses two- and three-year term interest rate swap agreements with variable rate receipts primarily based on SOFR (previously LIBOR) or Fed Funds to help mitigate exposure to rising short-term interest rates. During 2020, the Company took advantage of declining market rates to replace \$9.4 billion of longer-term swaps with new two- and three-year contracts at significantly lower rates to the benefit of future earnings. At year-end the Company held \$2.97 billion notional amount of portfolio financing-related interest rate swap agreements at fixed rates averaging 0.04%, with contract expirations occurring at various dates through the fourth quarter of 2023 and a weighted average expiration of 22 months.

Including the effects of these derivatives, the Company's residential mortgage investments and secured borrowings had estimated durations at December 31, 2020 of 14 and 10½ months, respectively, for a net duration gap of approximately 3½ months – see "Interest Rate Risk" for further information about the Company's sensitivity to changes in market interest rates. The Company intends to continue to manage

interest rate risk associated with holding and financing its residential mortgage investments by utilizing suitable derivative financial instruments such as interest rate swap agreements, Eurodollar futures and longer-maturity secured borrowings, if available at attractive rates and terms.

Utilization of Long-term Investment Capital and Potential Liquidity

Capstead's investment strategy involves managing an appropriately leveraged portfolio of primarily ARM Agency Securities that management believes can produce attractive risk-adjusted returns over the long term, while reducing, but not eliminating, sensitivity to changes in interest rates. The potential liquidity inherent in the Company's unencumbered residential mortgage investments is as important as the actual level of cash and cash equivalents carried on the balance sheet because secured borrowings generally can be increased or decreased on a daily basis to meet cash flow requirements and otherwise manage capital resources efficiently. Potential liquidity is affected by, among other factors:

- current portfolio leverage levels,
- changes in market value of assets pledged and derivatives held for hedging purposes as determined by lending and derivative counterparties,
- mortgage prepayment levels,
- availability of borrowings under repurchase arrangements with lending counterparties,
- collateral requirements of lending and derivative counterparties, and
- general conditions in the commercial banking and mortgage finance industries.

As of December 31, 2020, the Company's utilization of its long-term investment capital and its estimated potential liquidity were as follows in comparison with December 31, 2019 (dollars in thousands):

| | <i>Investments (a)</i> | <i>Secured Borrowings</i> | <i>Capital Employed</i> | <i>Potential Liquidity (b)</i> | <i>Portfolio Leverage</i> |
|--|------------------------|---------------------------|-------------------------|--------------------------------|---------------------------|
| Residential mortgage investments | \$ 7,937,552 | \$ 7,319,083 | \$ 618,469 | \$ 266,857 | |
| Cash collateral receivable from derivative counterparties, net (c) | | | 32,927 | — | |
| Other assets, net of other liabilities | | | 357,260 | 257,180 | |
| Balances as of December 31, 2020: | <u>\$ 7,937,552</u> | <u>\$ 7,319,083</u> | <u>\$ 1,008,656</u> | <u>\$ 524,037</u> | 7.26:1 |
| Balances as of December 31, 2019 | \$ 11,220,630 | \$ 10,274,498 | \$ 1,172,125 | \$ 537,134 | 8.77:1 |

(a) Investments are stated at balance sheet carrying amounts, which generally reflect estimated fair value as of the indicated dates.

(b) Potential liquidity is based on maximum amounts of borrowings available under existing uncommitted financing arrangements considering management's estimate of the fair value of residential mortgage investments held as of the indicated dates adjusted for other sources of liquidity such as cash and cash equivalents.

(c) Cash collateral receivable from derivative counterparties is presented net of cash collateral payable to derivative counterparties, if applicable, and the fair value of interest rate swap positions as of the indicated date.

In order to efficiently manage its liquidity and capital resources, Capstead attempts to maintain sufficient liquidity reserves to fund borrowing and derivative margin calls under stressed market conditions, including margin calls resulting from monthly principal payments (remitted to the Company 20 to 45 days after any given month-end), as well as reasonably possible declines in the market value of pledged assets and derivative positions. Should market conditions deteriorate, management may reduce portfolio leverage and increase liquidity by raising new equity capital, selling mortgage securities and/or curtailing the replacement of portfolio runoff. Additionally, the Company routinely does business with a large number of lending counterparties, which bolsters financial flexibility to address challenging market conditions and limits exposure to any individual counterparty. As of December 31, 2020, Capstead did not have any off-balance sheet arrangements.

In response to significant declines in longer-term interest rates experienced earlier in 2020, the Company reduced portfolio leverage by only replacing a portion of portfolio runoff, selling assets and by taking a

measured approach to deploying new common equity capital raised in February. The Company expects in the near-term for leverage to remain at or near these levels given current market conditions. Future levels of portfolio leverage will be dependent on many factors, including the size and composition of the Company's investment portfolio (see "Liquidity and Capital Resources").

Reconciliation of GAAP and non-GAAP Financial Measures

Management believes the presentation of core earnings and core earnings per common share, both non-GAAP financial measures, when analyzed in conjunction with the Company's GAAP operating results, allows investors to more effectively evaluate the Company's performance and provides investors with management's view of the Company's economic performance. The Company defines core earnings as GAAP net income (loss) excluding (a) unrealized gains or losses on derivative instruments, (b) realized gains or losses on termination of derivative instruments, (c) amortization of unrealized gains or losses of derivative instruments held at the time of de-designation, and (d) realized gains or losses on securities. The Company's presentation of core earnings may not be comparable to similarly-titled measures of other companies, who may use different calculations.

The following reconciles GAAP net (loss) income and net (loss) income per diluted common share to core earnings and core earnings per common share (dollars in thousands, except per share amounts):

| | <u>2020</u> | | <u>2019</u> | | <u>2018</u> | |
|---|------------------|------------------|------------------|------------------|------------------|------------------|
| | <u>Amount</u> | <u>Per Share</u> | <u>Amount</u> | <u>Per Share</u> | <u>Amount</u> | <u>Per Share</u> |
| Net (loss) income | \$ (129,573) | \$ (1.56) | \$ (35,338) | \$ (0.62) | \$ 50,072 | \$ 0.34 |
| Unrealized (gain) loss on non-designated derivative instruments | (7,455) | (0.08) | 17,656 | 0.20 | — | — |
| Realized loss on termination of non-designated derivative instruments | 149,942 | 1.57 | 95,187 | 1.07 | — | — |
| Amortization of unrealized gain, net of unrealized losses on de-designated derivative instruments | 529 | 0.00 | (14,712) | (0.17) | — | — |
| Realized loss on sale of investments | 67,820 | 0.71 | 1,365 | 0.02 | — | — |
| Core earnings | <u>\$ 81,263</u> | <u>\$ 0.64</u> | <u>\$ 64,158</u> | <u>\$ 0.50</u> | <u>\$ 50,072</u> | <u>\$ 0.34</u> |

Management believes that presenting financing spreads on residential mortgage investments, a non-GAAP financial measure, provides useful information for evaluating the performance of the Company's portfolio as opposed to total financing spreads because the non-GAAP measure speaks specifically to the performance of the Company's investment portfolio. The following reconciles these measures for the indicated periods:

| | 2020 | 2019 | 2018 | 2017 | 2016 |
|---|--------|--------|-------|-------|-------|
| Total financing spreads | 1.16% | 0.41% | 0.33% | 0.55% | 0.64% |
| Impact of yields on other interest-earning assets* | 0.03 | 0.00 | 0.00 | 0.01 | 0.02 |
| Impact of borrowing rates on other interest-paying liabilities* | 0.08 | 0.05 | 0.05 | 0.05 | 0.06 |
| Impact of amortization of unrealized gain, net of unrealized losses on de-designated derivative instruments | 0.00 | (0.14) | — | — | — |
| Impact of net cash flows received on non-designated derivative instruments | (0.20) | 0.21 | — | — | — |
| Financing spreads on residential mortgage investments | 1.07 | 0.53 | 0.38 | 0.61 | 0.72 |

* Other interest-earning assets consist of overnight investments and cash collateral receivable from derivative counterparties. Other interest-paying liabilities consist of unsecured borrowings and, at times, cash collateral payable to derivative counterparties.

Tax Considerations of Capstead Common and Preferred Stock Dividends

Capstead's common and preferred dividend distributions are generally characterized as ordinary income or nontaxable return of capital based on the relative amounts of the Company's earnings and profits (taxable income, after certain adjustments) to total distributions applicable for a given tax year. Total distributions are determined in accordance with the spillover distribution provisions of IRC 857(b)(9).

Under IRC 857(b)(9), REIT common dividends declared in the fourth quarter of a calendar year with a record date prior to year-end and a payable date in January of the following year will be included in total distributions in the year declared only to the extent of available earnings and profits. As a result, such fourth quarter common dividends may be pro-rated between tax years or may not be taxable until the following year. Capstead's common dividend declared in the fourth quarter of 2020 will be treated entirely as a 2021 distribution. Common dividends declared in the fourth quarters of 2019 and 2018 were treated entirely as 2020 and 2019 distributions, respectively. Characterization of common distributions allocable to 2020, 2019 and 2018 tax years were as follows:

| | 2020 | | 2019 | | 2018 | |
|-------------------|-------------------|-------|-------------------|-------|-------------------|--------|
| | Amount | % | Amount | % | Amount | % |
| Ordinary income | \$ - | - % | \$ - | - % | \$ 0.38262 | 63.8 % |
| Return of capital | 0.60000 | 100.0 | 0.40000 | 100.0 | 0.21738 | 36.2 |
| Total | <u>\$ 0.60000</u> | 100.0 | <u>\$ 0.40000</u> | 100.0 | <u>\$ 0.60000</u> | 100.0 |

Common distributions characterized as return on capital reduce the tax basis of related shares and are nontaxable to a recipient unless cumulative return of capital distributions received by a recipient exceed tax cost basis, in which case the excess is reportable as capital gain.

REIT preferred dividends are subject to the same spillover provisions under IRC 857(b)(9), although proration between tax years usually results in 100% of such dividends being included in total distributions in the year declared. All preferred dividends allocable to 2018 were characterized as ordinary income. However, Capstead did not have earnings and profits to distribute in 2019 and 2020. Accordingly, preferred dividends declared and paid in 2019 and 2020 are characterized as a nontaxable return of

capital. Further, preferred dividends declared in December of 2019 and 2020 and payable in January of 2020 and 2021 will be treated entirely as 2020 and 2021 distributions, respectively.

If in future years the Company realizes gains on sales of assets, a portion of its dividends may be characterized as long-term capital gains, provided such gains exceed available capital loss carryforwards. Any such capital gain distributions would be reported as long-term capital gains and would generally be taxed at lower rates than distributions of ordinary income. Unused capital loss carryforwards totaling \$17.5 million expired in 2019. At December 31, 2020 the Company had remaining net capital loss carryforwards of \$1.3 million that expire after 2024 and \$66.9 million that expire after 2025.

At December 31, 2020, the Company had net operating loss (NOL) carryforwards totaling \$13 million generated in 2019 and \$77 million generated in 2020. Under the provisions of the Tax Cuts and Jobs Act of 2017 (“Tax Act”), NOLs no longer expire, but a taxpayer can only offset up to 80% of its income in any given year with an NOL. Under the provisions of the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) of 2020, the 80% limitation is deferred to tax years starting after December 31, 2020. For tax years beginning before January 1, 2021, a taxpayer can offset 100% of its income in any given year with an NOL.

See the investor relations section of the Company’s website at www.capstead.com for additional dividend characterization information. Due to the complex nature of applicable tax rules, it is recommended that stockholders consult their tax advisors to ensure proper tax treatment of dividends received.

RESULTS OF OPERATIONS

| | <i>Year ended December 31</i> | | |
|--|-------------------------------|--------------------|------------------|
| | <i>2020</i> | <i>2019</i> | <i>2018</i> |
| Income statement data: <i>(in thousands, except per share data)</i> | | | |
| Interest income on residential mortgage investments | \$ 186,261 | \$ 320,109 | \$ 274,733 |
| Related interest expense | (67,891) | (246,140) | (206,881) |
| | <u>118,370</u> | <u>73,969</u> | <u>67,852</u> |
| Other interest income (expense) | (7,146) | (4,822) | (5,859) |
| | <u>111,224</u> | <u>69,147</u> | <u>61,993</u> |
| Other (expense) income: | | | |
| Loss on derivative instruments (net) | (159,547) | (90,578) | — |
| Loss on sale of investments (net) | (67,820) | (1,365) | — |
| Compensation-related expense | (8,278) | (8,197) | (7,759) |
| Other general and administrative expense | (5,011) | (4,494) | (4,527) |
| Miscellaneous other revenue | (141) | 149 | 365 |
| | <u>(240,797)</u> | <u>(104,485)</u> | <u>(11,921)</u> |
| Net (loss) income | <u>\$ (129,573)</u> | <u>\$ (35,338)</u> | <u>\$ 50,072</u> |
| Net (loss) income per diluted common share | \$ (1.56) | \$ (0.62) | \$ 0.34 |
| Average diluted common shares outstanding | 95,492 | 88,722 | 91,230 |
| Core earnings ^(a) | \$ 81,263 | \$ 64,158 | \$ 50,072 |
| Core earnings per diluted common share ^(a) | 0.64 | 0.50 | 0.34 |
| Key operating statistics: <i>(dollars in millions)</i> | | | |
| Average yields: | | | |
| Residential mortgage investments | 2.10% | 2.75% | 2.12% |
| Other interest-earning assets | 0.35 | 2.10 | 1.76 |
| Total average yields | 2.07 | 2.75 | 2.12 |
| Average borrowing rates: | | | |
| Secured borrowings ^{(a)(b)} | 1.03 | 2.22 | 1.74 |
| Unsecured borrowings | 7.74 | 7.74 | 7.75 |
| Total average borrowing rates | 1.11 | 2.27 | 1.79 |
| Average total financing spreads | 1.16 | 0.41 | 0.33 |
| Average financing spreads on residential mortgage investments ^(a) | 1.07 | 0.53 | 0.38 |
| Average CPR | 34.56 | 26.62 | 22.89 |
| Average balance information: | | | |
| Residential mortgage investments <i>(cost basis)</i> | \$ 8,888 | \$ 11,627 | \$ 12,944 |
| Other interest-earning assets | 135 | 135 | 99 |
| Secured borrowings | 8,205 | 10,752 | 11,884 |
| Unsecured borrowings <i>(included in long-term investment capital)</i> | 98 | 98 | 98 |
| Long-term investment capital (“LTIC”) | 1,036 | 1,158 | 1,258 |
| Operating costs as a percentage of average LTIC | 1.28% | 1.10% | 0.98% |
| Return on average common equity capital ^(c) | 9.01 | 5.54 | 3.38 |

(a) See “Reconciliation of GAAP and non-GAAP Financial Measures” for a reconciliation of these financial measures and the Company’s rationale for using these non-GAAP financial measures.

(b) To better compare the components of financing spreads on residential mortgage investments with prior periods, secured borrowing rates exclude the effects of amortization of the net unrealized gains and losses included in Accumulated other comprehensive income (loss) upon de-designation on March 1, 2019 of related derivatives held for hedging purpose of 0.00% and (0.14)%, and include net interest cash flows from that date on non-designated derivatives of (0.20)% and 0.21% during 2020 and 2019, respectively.

(c) Calculated using core earnings less preferred dividends on an annualized basis over average common equity for the period.

2020 Compared to 2019

Capstead reported for GAAP purposes a net loss of \$130 million or \$(1.56) per diluted common share during 2020. This compares to a net loss of \$35 million or \$(0.62) per diluted common share for 2019. GAAP net loss was negatively affected during 2020 primarily by losses on hedging-related derivatives of \$160 million due largely to lower prevailing interest rates and losses on sales of investments of \$68 million due to COVID-19 pandemic related disruptions to the fixed income markets.

Capstead's core earnings, a non-GAAP financial measure, totaled \$81 million or \$0.64 per diluted common share during 2020, compared to core earnings of \$64 million or \$0.50 per diluted common share for 2019. Core earnings in 2020 benefited from lower borrowing rates while being hampered by lower yields on residential mortgage investments and lower average portfolio balances following asset sales in response to the COVID-19 pandemic in late March.

Interest income on residential mortgage investments was lower by \$134 million in 2020 compared to 2019. The decrease is attributable to \$67 million in decreases related to lower average yields and \$67 million in decreases related to lower average portfolio balances during 2020.

Yields on residential mortgage investments were 65 basis points lower, averaging 2.10% during 2020, compared to 2.75% reported for 2019, primarily due to lower coupon interest rates on loans underlying the Company's ARM Agency Securities that have reset based on lower prevailing interest rates, as well as lower coupons on acquisitions and other changes in portfolio composition. Yields were also negatively impacted by higher premium amortization compared to 2019 due primarily to higher prepayment rates experienced on the portfolio.

Historically low interest rates have led to exceedingly high prepayment speeds across all mortgage products as homeowners have taken advantage of this opportunity to refinance their mortgage loans. While ARM securities are priced to incur higher prepayment speeds than fixed rate securities, and fixed rate securities have incurred higher percentage increases than ARM securities over previous levels, the Company's ARM securities have experienced elevated prepayment speeds ultimately hurting yields on its investments. The Company expects prepayment speeds will remain elevated due to the interest rate environment in 2021.

Interest expense on secured borrowings was lower by \$178 million in 2020 compared to 2019. The decrease is attributable to \$130 million in decreases related to lower average borrowing rates and \$48 million in decreases related to lower average borrowings during 2020.

Secured borrowing rates, after adjusting for hedging activities, decreased 119 basis points to average 1.03% in 2020, compared to 2.22% reported for 2019. Market conditions contributed to lower borrowing rates, including 75 basis points in decreases to the Federal Funds rate during the last half of 2019 followed by 150 basis points in rate cuts in March 2020. Average fixed-rate swap payments were 1.19% in 2020 compared to 2.07% in 2019. This decline was due to efforts to reposition the swap portfolio to take advantage of declining market interest rates and maturing high-cost swap positions over the course of 2019 and 2020, as well as a reduction in swap positions due to asset sales in March 2020. Swap balances were lower, averaging \$4.75 billion in 2020 compared to \$7.46 billion reported for 2019. Future secured borrowing rates will be dependent on market conditions, including overall levels of market interest rates as well as the availability of longer-maturity borrowings and interest rate swap agreements at attractive rates.

Other interest expense (net) during 2020 was lower due to a 175 basis point decrease in rates on overnight investments and cash collateral receivable from derivative counterparties. Borrowing costs on the Company's \$100 million face amount of outstanding unsecured borrowings are effectively fixed utilizing swap agreements with matching terms.

Operating costs of \$13 million were higher in 2020 compared to 2019 by \$598,000, primarily due to higher long-term incentive program accruals. Capstead remains a highly efficient investment platform, particularly compared to other mortgage REITs. Key components of the Company's operating efficiency include its internally-managed structure and agency-focused investment strategy.

LIQUIDITY AND CAPITAL RESOURCES

Capstead's primary sources of funds are secured borrowings and monthly principal and interest payments on its investments. Other sources of funds may include proceeds from debt and equity offerings and asset sales. The timing, manner, price and amount of any future common and preferred issuances and any common stock repurchases will be made in the open market at the Company's discretion, subject to economic and market conditions, stock price, compliance with federal securities laws and tax regulations as well as blackout periods associated with the dissemination of important Company-specific news.

The Company generally uses its liquidity to pay down secured borrowings to reduce borrowing costs and otherwise efficiently manage its long-term investment capital. Because the level of these borrowings can generally be adjusted on a daily basis, the Company's potential liquidity inherent in its unencumbered residential mortgage investments is as important as the level of cash and cash equivalents carried on the balance sheet. The table included under "Utilization of Long-term Investment Capital and Potential Liquidity" illustrates management's estimate of additional funds potentially available to the Company at December 31, 2020. The discussion accompanying this table and under "COVID-19 Pandemic" provides insight into the Company's current liquidity position and perspective on what level of portfolio leverage to employ under current market conditions. The Company currently believes that it has sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on borrowings and the payment of cash dividends as required for the Company's continued qualification as a REIT.

Capstead finances its residential mortgage investments primarily by borrowing under repurchase arrangements, the terms and conditions of which are negotiated on a transaction-by-transaction basis, when each such borrowing is initiated or renewed.

Future borrowings are dependent upon the willingness of lenders to participate in the financing of mortgage investments, lender collateral requirements and the lenders' determination of the fair value of the investments pledged as collateral, which fluctuates with changes in interest rates and liquidity conditions within the commercial banking and mortgage finance industries. None of the Company's borrowing counterparties are obligated to renew or otherwise enter into new borrowings at the conclusion of existing borrowings. Secured borrowings began 2020 at \$10.28 billion, averaged \$8.21 billion during the year, and ended the year at \$7.32 billion, with \$6.82 billion maturing within 90 days and \$500 million maturing within 12 months. Average secured borrowings can differ from period-end balances for a number of reasons including portfolio growth or contraction, as well as differences in the timing of portfolio acquisitions relative to portfolio runoff.

To help mitigate exposure to rising short-term interest rates, the Company uses derivatives supplemented with longer-maturity secured borrowings when available at attractive rates and terms. At year-end the Company held \$3.0 billion notional amount of portfolio financing-related interest rate swap agreements with contract expirations occurring at various dates through the fourth quarter of 2023 and a weighted average expiration of 22 months. At December 31, 2020, the Company expects to have no net cash obligations related to secured borrowings-related interest rate swap agreements after considering the variable-rate payments owed to the Company under the agreements' terms based on market interest rate expectations as of year-end. Additionally, the Company entered into swap agreements effectively locking in lower fixed rates of interest during the 20-year floating rate terms of the Company's \$100 million face amount of unsecured borrowings that mature in 2035 and 2036. The Company's cash obligation on these borrowings and related swap agreements is \$7 million annually until maturity. The Company intends to continue to utilize suitable derivative financial instruments such as interest rate swap agreements or other derivatives and longer-maturity secured borrowings to manage interest rate risk when available at attractive rates and terms.

During February 2020, Capstead issued 1.6 million shares of common stock through an at-the-market continuous offering program at an average issue price of \$8.21, net of fees and other costs, for net proceeds of \$12.9 million. Additional amounts of equity capital may be raised in the future under continuous offering programs or by other means, subject to market conditions, compliance with federal securities laws and blackout periods.

Interest Rate Risk

Because Capstead's residential mortgage investments consist almost entirely of Agency Securities, which are considered to have limited, if any, credit risk, interest rate risk is the primary market risk faced by the Company. Interest rate risk is highly sensitive to a number of factors, including economic conditions, government fiscal policy, central bank monetary policy and banking regulation. By focusing primarily on investing in relatively short-duration ARM Agency Securities, declines in fair value caused by increases in interest rates are typically relatively modest compared to fixed-rate portfolios. These declines can be recovered in a relatively short period of time as coupon interest rates on the underlying mortgage loans reset to rates more reflective of the then-current interest rate environment. This strategy also positions the Company to benefit from future recoveries in financing spreads that typically contract during periods of rising interest rates.

Derivatives and longer-maturity secured borrowings lengthen the effective duration of the Company's secured borrowings to more closely match the duration of its portfolio of residential mortgage investments. After consideration of derivative positions held to hedge changes in secured borrowing rates, at December 31, 2020 the Company's residential mortgage investments and secured borrowings had estimated durations of 14 and 10½ months, for a net duration gap of approximately 3½ months. The Company intends to continue to manage interest rate risk associated with holding and financing its residential mortgage investments by utilizing suitable derivative financial instruments such as interest rate swap agreements or other derivatives and longer-maturity secured borrowings, if available at attractive rates and terms.

Capstead performs sensitivity analyses using a model to estimate the effects that specific interest rate changes can reasonably be expected to have on net interest margins and portfolio values. All investments, secured borrowings and related derivatives held are included in these analyses. For net interest margin modeling purposes, the model incorporates management's assumptions for mortgage prepayment levels for a given interest rate change using market-based estimates of prepayment speeds for the purpose of amortizing investment premiums and reinvesting portfolio runoff. These assumptions are developed through a combination of historical analysis and expectations for future pricing behavior under normal market conditions unaffected by changes in market liquidity. For portfolio valuation modeling purposes, a static portfolio is assumed.

This model is the primary tool used by management to assess the direction and magnitude of changes in net interest margins and portfolio values resulting solely from changes in interest rates. Key modeling assumptions include mortgage prepayment speeds, adequate levels of market liquidity, current market conditions, index floors and portfolio leverage levels. These assumptions are inherently uncertain and, as a result, modeling cannot precisely estimate the impact of higher or lower interest rates. Actual results will differ from simulated results due to the timing, magnitude and frequency of interest rate changes, other changes in market conditions, changes in management strategies and other factors.

The following table reflects the estimated impact of instantaneous parallel shifts in the yield curve on net interest margins and the fair value of Capstead's portfolio of residential mortgage investments and related derivative financial instruments at December 31, 2020 and 2019, subject to the modeling parameters described above.

| | Federal Funds Rate | 10-Year U.S. Treasury Rate | Down 1.00% | Down 0.50% | Up 0.50% | Up 1.00% |
|---|-----------------------------------|---|-----------------------|-----------------------|---------------------|---------------------|
| Projected 12-month percentage change in net interest margins: (a)(b) | | | | | | |
| December 31, 2020 | 0.00-0.25% | 0.92% | 11.3% | 5.0% | (3.4)% | (9.0)% |
| December 31, 2019 | 1.50-1.75 | 1.92 | 1.6 | 1.2 | (0.6) | (3.7) |
| Projected percentage change in portfolio and related derivative values: (a) | | | | | | |
| December 31, 2020 | 0.00-0.25 | 0.92 | (0.1) | - | (0.4) | (0.7) |
| December 31, 2019 | 1.50-1.75 | 1.92 | (0.1) | - | (0.2) | (0.4) |

(a) Sensitivity of net interest margins as well as portfolio and related derivative values to changes in interest rates is determined relative to the actual rates at the applicable date. Note that the projected 12-month net interest margin change is predicated on acquisitions of similar assets sufficient to replace runoff. There can be no assurance that suitable investments will be available for purchase at attractive prices, if investments made will behave in the same fashion as assets currently held or if management will choose to replace runoff with such assets.

(b) The change in the projected Down 1.00 and 0.50% scenarios at December 31, 2020 compared to December 31, 2019 primarily relates to the significant declines seen in interest rates during 2020. The model assumes a floor on all pertinent market indices of 0.00% except the Federal Funds rate and borrowing rates, which have no assumed floor.

CRITICAL ACCOUNTING POLICIES

Management's discussion and analysis of financial condition and results of operations is based upon Capstead's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the use of estimates and judgments that can affect the reported amounts of assets, liabilities (including contingencies), revenues and expenses, as well as related disclosures. These estimates are based on available internal and market information and appropriate valuation methodologies believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the expected useful lives and carrying values of assets and liabilities which can materially affect the determination of net income and book value per common share. Actual results may differ from these estimates under different assumptions or conditions.

Management believes the following are critical accounting policies in the preparation of Capstead's consolidated financial statements that involve the use of estimates requiring considerable judgment:

- *Amortization of investment premiums on residential mortgage investments* – Investment premiums on residential mortgage investments are recognized in earnings as adjustments to interest income by the interest method over the estimated lives of the related assets. Amortization is affected by actual portfolio runoff (scheduled and unscheduled principal paydowns) and by estimates and judgments related to future levels of mortgage prepayments that may be necessary to achieve the required effective yield over the estimated life of the related investment.

Mortgage prepayment expectations can change based on how current and projected changes in interest rates impact the economic attractiveness of mortgage refinance opportunities, if available, and other factors such as lending industry underwriting practices and capacity constraints, regulatory changes, borrower credit profiles and the health of the economy and housing markets. Management estimates future mortgage prepayments based on these factors and past experiences with specific investments within the portfolio. Should actual prepayment rates differ materially from these estimates, investment premiums would be expensed at a different pace.

- *Fair value and impairment accounting for residential mortgage investments* – Nearly all of Capstead's residential mortgage investments are held in the form of mortgage securities that are classified as available-for-sale and recorded at fair value on the balance sheet with unrealized gains and losses recorded in *Stockholders' equity* as a component of *Accumulated other comprehensive income*. Fair values fluctuate with current and projected changes in interest rates, prepayment expectations and other factors such as market liquidity conditions and the perceived credit quality of Agency Securities. Judgment is required to interpret market data and develop estimated fair values, particularly in circumstances of deteriorating credit quality and market liquidity. See NOTE 8 to the Consolidated Financial Statements for discussion of how Capstead values its residential mortgage investments.

Generally, gains or losses are recognized in earnings only if securities are sold; however, if a decline in fair value of a mortgage security below its amortized cost occurs, the difference between amortized cost and fair value would be recognized in earnings as a component of *Other (expense) income* if the decline was credit-related or it was determined to be more likely than not that the Company will incur a loss via an asset sale.

- *Accounting for derivative instruments* – Derivatives are recorded as assets or liabilities and carried at fair value. Fair values fluctuate with current and projected changes in interest rates and other factors such as the Company’s and its counterparties’ nonperformance risk. Judgment is required to develop estimated fair values.

The accounting for changes in fair value of each derivative held depends on whether it has been designated as an accounting hedge, as well as the type of hedging relationship identified. To qualify as a cash flow hedge for accounting purposes, at the inception of the hedge relationship the Company must anticipate and document that the hedge relationship will be highly effective and must monitor ongoing effectiveness on at least a quarterly basis. As long as the hedge relationship remains highly effective, changes in fair value of the derivative are recorded in *Accumulated other comprehensive income*. Changes in fair value of derivatives not held as accounting hedges, or for which the hedge relationship is deemed to no longer be highly effective and as a result hedge accounting is terminated, are recorded in earnings as a component of *Other (expense) income*.

The Company uses derivatives primarily in the form of interest rate swap agreements to hedge the variability in borrowing rates on its secured borrowings and unsecured borrowings. For derivatives designated as accounting hedges, fixed interest payments and variable interest receipts are recorded as an adjustment to interest expense on the related designated borrowings. For derivatives not designated as accounting hedges, fixed interest payments and variable interest receipts are recorded as a component of *Other (expense) income*. For derivatives initially designated as an accounting hedge and subsequently de-designated, any unrealized gain or loss included in *Accumulated other comprehensive income* at the time of de-designation is amortized as an adjustment to interest expense on the related borrowings over the remaining term of the derivatives. See “Financial Condition – Residential Mortgage Investments” and NOTE 6 to the Consolidated Financial Statements for additional information regarding the Company’s current use of derivatives and its related risk management policies.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISKS

The information required by this item is included above in Item 7 of this report, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to Financial Statements

| | <u>Page</u> |
|---|-------------|
| Report of Independent Registered Public Accounting Firm | 33 |
| Consolidated Balance Sheets at December 31, 2020 and December 31, 2019 | 35 |
| Consolidated Statements of Operations for the years ended December 31, 2020, 2019 and 2018 | 36 |
| Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2020, 2019 and 2018 | 37 |
| Consolidated Statements of Stockholders’ Equity for the years ended December 31, 2020, 2019 and 2018 | 38 |
| Consolidated Statements of Cash Flows for the years ended December 31, 2020, 2019 and 2018 | 39 |
| Notes to the Consolidated Financial Statements | 40 |

All financial statement schedules are omitted because they are not applicable or the required information is included in the consolidated financial statements and notes thereto.

Financial statements of subsidiaries have been omitted as such entities do not individually or in the aggregate exceed the 20% threshold under either the investment or income tests applicable under the appropriate regulations for inclusion. The Company owned 100% of each of its subsidiaries.

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Capstead Mortgage Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Capstead Mortgage Corporation (the Company) as of December 31, 2020 and 2019, the related consolidated statements of operations, comprehensive income (loss), stockholders' equity and cash flows for each of the three years in the period ended December 31, 2020, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2020, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2020, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 19, 2021 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective or complex judgments. The communication of a critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Residential mortgage investments – Debt Securities

Description of the Matter Residential mortgage investments totaled \$7.94 billion at December 31, 2020, consisting of Agency Securities classified as available-for-sale. As explained in Note 2 and Note 8 of the consolidated financial statements, residential mortgage investments are carried at fair value at each reporting date with unrealized gains and losses reported as a separate component of Accumulated other comprehensive income (loss). Fair values are influenced by current and projected changes in interest rates, prepayment expectations, market liquidity conditions and other factors including consideration of recent trading activity for similar investments and pricing levels.

Auditing the Company's accounting for certain securities within its residential mortgage investments portfolio was complex due to the estimation uncertainty in determining the fair value as these securities, which represent 1.95% of the portfolio of Residential mortgage investments, tend to have higher uncertainty in prepayment expectations, less recent trading activity or variability in pricing levels.

How We Addressed the Matter in Our Audit We evaluated and tested the design and operating effectiveness of controls addressing the identified risks related to the Company's process used in determining the valuation of residential mortgage investments, including management's review of available third-party pricing data. We also tested management's controls over the completeness and accuracy of the data used in the valuation.

Our audit procedures included, among others, independently pricing a sample of these securities which involved internally developing fair value estimates using independently derived data for significant assumptions (e.g. prepayment rate and portfolio yield) to compare with management's determined prices. We involved an internal valuation specialist and third-party data in our procedures. Additionally, we performed analytical procedures, which included a sensitivity analysis to understand the impact of a change in average fair value compared to management's mark-to-market adjustment for these securities.

/s/ ERNST & YOUNG, LLP

We have served as the Company's auditor since 1985
Dallas, Texas
February 19, 2021

CONSOLIDATED BALANCE SHEETS

(In thousands, except pledged and per share amounts)

| | <i>December 31</i> | |
|---|--------------------|---------------|
| | <i>2020</i> | <i>2019</i> |
| Assets | | |
| Residential mortgage investments (\$7.71 and \$10.83 billion pledged at December 31, 2020 and 2019, respectively) | \$ 7,937,552 | \$ 11,220,630 |
| Cash collateral receivable from derivative counterparties | 74,411 | 65,477 |
| Derivatives at fair value | – | 1,471 |
| Cash and cash equivalents | 257,180 | 105,397 |
| Receivables and other assets | 136,107 | 127,026 |
| | \$ 8,405,250 | \$ 11,520,001 |
| Liabilities | | |
| Secured borrowings | \$ 7,319,083 | \$ 10,274,498 |
| Derivatives at fair value | 41,484 | 29,156 |
| Unsecured borrowings | 98,493 | 98,392 |
| Common stock dividend payable | 15,281 | 14,605 |
| Accounts payable and accrued expenses | 20,746 | 29,617 |
| | 7,495,087 | 10,446,268 |
| Stockholders' equity | | |
| Preferred stock - \$0.10 par value; 100,000 shares authorized: 7.50% Cumulative Redeemable Preferred Stock, Series E, 10,329 shares issued and outstanding (\$258,226 aggregate liquidation preference) at December 31, 2020 and 2019 | 250,946 | 250,946 |
| Common stock - \$0.01 par value; 250,000 shares authorized: 96,481 and 94,606 shares issued and outstanding at December 31, 2020 and 2019, respectively | 965 | 946 |
| Paid-in capital | 1,268,439 | 1,252,481 |
| Accumulated deficit | (651,071) | (444,039) |
| Accumulated other comprehensive income | 40,884 | 13,399 |
| | 910,163 | 1,073,733 |
| | \$ 8,405,250 | \$ 11,520,001 |

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

| | <i>Year ended December 31</i> | | |
|---|-------------------------------|-------------|-------------|
| | <i>2020</i> | <i>2019</i> | <i>2018</i> |
| Interest income | | | |
| Residential mortgage investments | \$ 186,261 | \$ 320,109 | \$ 274,733 |
| Other | 474 | 2,789 | 1,752 |
| | 186,735 | 322,898 | 276,485 |
| Interest expense | | | |
| Secured borrowings | (67,891) | (246,140) | (206,881) |
| Unsecured borrowings | (7,620) | (7,611) | (7,611) |
| | (75,511) | (253,751) | (214,492) |
| Net interest income | 111,224 | 69,147 | 61,993 |
| Other (expense) income: | | | |
| Loss on derivative instruments (net) | (159,547) | (90,578) | – |
| Loss on sale of investments (net) | (67,820) | (1,365) | – |
| Compensation-related expense | (8,278) | (8,197) | (7,759) |
| Other general and administrative expense | (5,011) | (4,494) | (4,527) |
| Miscellaneous other (expense) revenue | (141) | 149 | 365 |
| | (240,797) | (104,485) | (11,921) |
| Net (loss) income | (129,573) | (35,338) | 50,072 |
| Less preferred stock dividends | (19,368) | (19,368) | (19,368) |
| Net (loss) income available to common stockholders | \$ (148,941) | \$ (54,706) | \$ 30,704 |
| Basic and diluted net (loss) income per common share | \$ (1.56) | \$ (0.62) | \$ 0.34 |

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

| | <i>Year ended December 31</i> | | |
|---|-------------------------------|--------------------|--------------------|
| | <i>2020</i> | <i>2019</i> | <i>2018</i> |
| Net (loss) income | <u>\$ (129,573)</u> | <u>\$ (35,338)</u> | <u>\$ 50,072</u> |
| Other comprehensive income (loss) | | | |
| Amounts related to available-for-sale securities: | | | |
| Change in net unrealized gain or loss | (27,580) | 71,148 | (72,490) |
| Reclassification adjustment for amounts included in net (loss) income | 66,864 | 1,365 | – |
| Amounts related to cash flow hedges: | | | |
| Change in net unrealized gain or loss | (15,621) | (17,080) | 25,716 |
| Reclassification adjustment for amounts included in net (loss) income | 3,822 | (20,988) | (36,390) |
| | <u>27,485</u> | <u>34,445</u> | <u>(83,164)</u> |
| Comprehensive loss | <u>\$ (102,088)</u> | <u>\$ (893)</u> | <u>\$ (33,092)</u> |

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands, except per share amounts)

| | <i>Preferred Stock</i> | <i>Common Stock</i> | <i>Paid-in Capital</i> | <i>Accumulated Deficit</i> | <i>Accumulated Other Comprehensive Income (Loss)</i> | <i>Total Stockholders' Equity</i> |
|---|----------------------------|-------------------------|----------------------------|--------------------------------|--|---|
| Balance at December 31, 2017 | 250,946 | 957 | 1,271,425 | (346,570) | 62,118 | 1,238,876 |
| Net income | – | – | – | 50,072 | – | 50,072 |
| Change in unrealized gain on mortgage securities, net | – | – | – | – | (72,490) | (72,490) |
| Amounts related to cash flow hedges, net | – | – | – | – | (10,674) | (10,674) |
| Cash dividends: | | | | | | |
| Common – \$0.49 per share | – | – | (13,759) | (30,704) | – | (44,463) |
| Preferred – \$1.875 per share | – | – | – | (19,368) | – | (19,368) |
| Common stock repurchases | – | (107) | (84,487) | – | – | (84,594) |
| Other additions to capital | – | 3 | 1,701 | – | – | 1,704 |
| Balance at December 31, 2018 | 250,946 | 853 | 1,174,880 | (346,570) | (21,046) | 1,059,063 |
| Net loss | – | – | – | (35,338) | – | (35,338) |
| Change in unrealized gain on mortgage securities, net | – | – | – | – | 72,513 | 72,513 |
| Amounts related to cash flow hedges, net | – | – | – | – | (38,068) | (38,068) |
| Cash dividends: | | | | | | |
| Common – \$0.47 per share | – | – | – | (42,763) | – | (42,763) |
| Preferred – \$1.875 per share | – | – | – | (19,368) | – | (19,368) |
| Issuance of common stock | – | 90 | 75,012 | – | – | 75,102 |
| Other additions to capital | – | 3 | 2,589 | – | – | 2,592 |
| Balance at December 31, 2019 | \$250,946 | \$ 946 | \$1,252,481 | \$ (444,039) | \$ 13,399 | \$1,073,733 |
| Net loss | – | – | – | (129,573) | – | (129,573) |
| Change in unrealized gain on mortgage securities, net | – | – | – | – | 39,284 | 39,284 |
| Amounts related to cash flow hedges, net | – | – | – | – | (11,799) | (11,799) |
| Cash dividends: | | | | | | |
| Common – \$0.60 per share | – | – | – | (58,091) | – | (58,091) |
| Preferred – \$1.875 per share | – | – | – | (19,368) | – | (19,368) |
| Issuance of common stock | – | 16 | 12,841 | – | – | 12,857 |
| Other additions to capital | – | 3 | 3,117 | – | – | 3,120 |
| Balance at December 31, 2020 | \$250,946 | \$ 965 | \$1,268,439 | \$ (651,071) | \$ 40,884 | \$ 910,163 |

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

| | <i>Year ended December 31</i> | | |
|---|-------------------------------|-------------------|--------------------|
| | <i>2020</i> | <i>2019</i> | <i>2018</i> |
| Operating activities: | | | |
| Net (loss) income | \$ (129,573) | \$ (35,338) | \$ 50,072 |
| Adjustments to reconcile net (loss) income to cash provided by operating activities: | | | |
| Amortization of investment premiums | 77,560 | 73,740 | 115,333 |
| Amortization of equity-based awards | 3,234 | 2,724 | 1,783 |
| Amortization of unrealized loss (gain) on de-designated hedges | 529 | (14,712) | – |
| Loss on sale of mortgage investments | 67,820 | 1,365 | – |
| Loss on derivative instruments (net) | 142,483 | 112,834 | – |
| Other depreciation and amortization | 124 | 110 | 110 |
| Net change in receivables, other assets, accounts payable and accrued expenses | (3,834) | 14,331 | (2,102) |
| Net cash provided by operating activities | <u>158,343</u> | <u>155,054</u> | <u>165,196</u> |
| Investing activities: | | | |
| Purchases of residential mortgage investments | (3,173,342) | (3,316,158) | (2,302,656) |
| Proceeds from sales of residential mortgage investments | 2,558,871 | 303,991 | – |
| Interest receivable acquired with the purchase of residential mortgage investments | (5,024) | (6,422) | (4,476) |
| Principal collections on residential mortgage investments, including changes in mortgage securities principal remittance receivable | 3,772,086 | 3,751,570 | 3,607,459 |
| Redemption of lending counterparty investment | – | 5,000 | – |
| Net cash provided by investing activities | <u>3,152,591</u> | <u>737,981</u> | <u>1,300,327</u> |
| Financing activities: | | | |
| Proceeds from repurchase arrangements and similar borrowings | 82,969,163 | 138,721,910 | 173,854,358 |
| Principal payments on repurchase arrangements and similar borrowings | (85,924,578) | (139,425,767) | (175,205,622) |
| (Increase) decrease in cash collateral receivable from interest rate swap counterparties | (8,934) | (33,680) | 10,709 |
| Net payments on interest rate swap settlements | (130,793) | (130,802) | (8,734) |
| Common stock repurchases | – | – | (84,594) |
| Issuance of common stock | 12,882 | 75,195 | – |
| Other capital stock transactions | (108) | (106) | (72) |
| Dividends paid | (76,783) | (54,677) | (75,186) |
| Net cash used in financing activities | <u>(3,159,151)</u> | <u>(847,927)</u> | <u>(1,509,141)</u> |
| Net change in cash and cash equivalents | <u>151,783</u> | <u>45,108</u> | <u>(43,618)</u> |
| Cash and cash equivalents at beginning of year | <u>105,397</u> | <u>60,289</u> | <u>103,907</u> |
| Cash and cash equivalents at end of year | <u>\$ 257,180</u> | <u>\$ 105,397</u> | <u>\$ 60,289</u> |

See accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — BUSINESS

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

NOTE 2 — ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements include the accounts of Capstead Mortgage Corporation and its wholly-owned and majority-owned subsidiaries over which it exercises control. Pursuant to variable interest entity (“VIE”) accounting principles, Capstead considers for consolidation any VIE in which it holds an interest. Intercompany balances and transactions are eliminated.

Recent Accounting Pronouncements

In June 2016, Accounting Standards Update No. 2016-13, Financial Instruments – Credit Losses (“ASU 2016-13”) was issued which replaced the incurred loss impairment methodology in previous GAAP with a methodology that is designed to better reflect expected credit losses. For financial instruments carried at amortized cost, impairment is measured as a current estimate of expected lifetime credit losses. For available-for-sale debt securities in which changes in fair value are recorded in accumulated other comprehensive income, the write-down of available-for-sale securities under the “other-than-temporarily” impaired model was replaced with an allowance for credit losses model. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. The Company adopted ASU 2016-13 on January 1, 2020 which had no material effect on the Company’s results of operations, financial condition and cash flows primarily due to the limited, if any, credit risk of Agency Securities.

Use of Estimates

Fair values of nearly all financial instruments held by the Company are estimated based on a market approach using available market information and appropriate valuation methodologies (Level Two Inputs); however, judgment is required in interpreting market data to develop these estimates. Fair values fluctuate on a daily basis and are influenced by changes in, and market expectations for changes in, interest rates, market liquidity conditions and levels of mortgage prepayments, as well as other factors. Accordingly, estimates of fair value are as of the balance sheet dates and are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and estimation methodologies may have a material effect on estimated fair values. Judgment is also exercised in making impairment conclusions and estimating impairment charges.

Amortization of investment premiums on financial assets is based in part on estimates of future levels of mortgage prepayments. Estimates are influenced by changes in, and market expectations for changes in, interest rates, market liquidity conditions, actual levels of mortgage prepayments and other factors. Judgment is required in developing these estimates, however the actual level of mortgage prepayments for a given accounting period is the single largest determinant in amortizing investment premiums.

Cash and Cash Equivalents

Cash and cash equivalents include unrestricted cash on hand and highly liquid investments with original maturities of three months or less when purchased.

Financial Assets

Capstead's financial assets consist of Agency Securities classified as available-for-sale and carried at fair value with net unrealized gains and losses reported as a separate component of *Accumulated other comprehensive income*. Interest is recorded as income when earned. Investment premiums and discounts are recognized as adjustments to interest income by the interest method over the expected life of the related financial assets. Realized gains and losses from any financial asset sales are recorded as a component of *Other (expense) income*. The specific identification method is used to determine the cost of financial assets sold. Financial assets are reviewed for potential impairment at each balance sheet date. Impairments of investments in mortgage securities can occur with changes in the Company's intent or ability to hold the mortgage securities until any declines in fair value are recovered and as a result of adverse changes in the financial condition of the issuer(s) such that a full recovery of cost basis is no longer expected. The amount of any such impairment is measured by comparing the recorded amount of the security to its fair value. If the decline in fair value is credit-related, an allowance for credit losses would be recognized in earnings as a component of *Other (expense) income*. If it was determined to be more likely than not that the Company will incur a loss via an asset sale, the difference between amortized cost and fair value would be recognized in earnings as a component of *Other (expense) income*.

Borrowings

Secured borrowings in the form of repurchase arrangements create exposure to the potential for failure on the part of counterparties to honor their commitment to return pledged collateral. In the event of a default by a repurchase arrangement counterparty, the Company may have difficulty recovering its collateral. To mitigate this risk, the Company monitors the creditworthiness of its counterparties and manages its exposure to any single counterparty.

Capstead's borrowings are carried at their principal balances outstanding net of related debt issuance costs and debt discounts, if applicable. Debt issuance costs associated with *Unsecured borrowings* are recognized as adjustments to interest expense by the interest method over the term of these borrowings.

Derivative Financial Instruments ("Derivatives")

Derivatives used by Capstead for risk management purposes are carried at fair value as assets or liabilities. The accounting for changes in fair value of Derivatives held depends on whether it has been designated as a hedge for accounting purposes, as well as the type of hedging relationship identified. Capstead may designate any Derivatives held as cash flow hedges related to a designated portion of its current and anticipated future borrowings. To qualify as a cash flow hedge, at the inception of the hedge relationship the Company must document that the hedge relationship is anticipated to be highly effective and monitor ongoing effectiveness on at least a quarterly basis. As long as the hedge relationship remains effective, the change in fair value of the Derivatives are recorded in *Accumulated other comprehensive income*. Changes in fair value of Derivatives not held as accounting hedges, if any, or for which the hedge relationship is no longer considered highly effective, are recorded in earnings as a component of *Other (expense) income*. On March 1, 2019 the Company discontinued its use of hedge accounting on its interest rate swaps related to *Secured borrowings*, while retaining hedge accounting for swaps related to *Unsecured borrowings*.

The Company uses Derivatives primarily in the form of interest rate swap agreements to hedge the variability in borrowing rates on its secured and unsecured borrowings. If designated as accounting hedges, related fixed interest payments and variable interest receipts are recorded as an adjustment to interest expense on the related designated borrowings. If not designated as accounting hedges, fixed

interest payments and variable interest receipts are recorded as a component of *Other (expense) income*. For Derivatives initially designated as accounting hedges and subsequently de-designated, unrealized gain or loss included in *Accumulated other comprehensive income* at the time of de-designation is amortized as an adjustment to interest expense on the related borrowings over the remaining term of the Derivatives.

Derivatives create exposure to credit risk related to the potential for failure on the part of counterparties to honor their commitments. In addition, the Company is required to post collateral primarily based on any declines in the market value of the Derivatives. In the event of default by a counterparty, the Company may have difficulty recovering its collateral and may not receive payments provided for under the terms of the Derivatives. Pursuant to regulatory changes implemented in 2013, most Derivatives held at December 31, 2020 were entered into through Derivative exchanges established in part to mitigate credit risk.

Cash collateral receivable from derivative counterparties, when present, represents cash remitted to swap counterparties to meet initial and ongoing margin requirements that are based on the fair value of these Derivatives, including related interest receivable or payable under the terms of the agreements. The Company may also remit mortgage securities to certain of its swap counterparties to meet ongoing margin requirements. Such mortgage securities, if any, are included in *Residential mortgage investments*. Similarly, *Cash collateral payable to derivative counterparties*, when present, represents cash received from counterparties to meet margin call requirements. For presentation purposes, the Company does not offset individual counterparty collateral receivables (or payables) with the recorded fair value of related interest rate swap agreements pursuant to master netting arrangements. In addition, gross unrealized gains on Derivatives (recorded as assets) are stated separately from gross unrealized losses (recorded as liabilities) without regard to counterparty. Certain cash margin amounts are presented on a net basis against the fair value of related Derivatives.

Long-term Incentive Compensation

Capstead provides its employees and its directors with long-term incentive compensation in the form of equity-based awards. Equity-based compensation costs are initially measured at the estimated fair value of the awards on the grant date developed using appropriate valuation methodologies. Valuation methodologies used and subsequent expense recognition is dependent upon each award's service and performance conditions, the latter also referred to as performance metrics. Capstead has elected not to estimate future award forfeitures when valuing equity-based awards and adjusts compensation costs as actual forfeitures occur.

Compensation costs for equity-based awards subject only to service conditions are measured at the closing stock price on the dates of grant and are recognized as expense on a straight-line basis over the requisite service periods for the awards, as adjusted for any forfeitures. Compensation costs for components of equity-based awards subject to nonmarket-based performance metrics (i.e. metrics not predicated on changes in the Company's stock price), are measured at the closing stock price on the dates of grant, adjusted for the probability of achieving benchmarks included in the performance metrics. These initial cost estimates are recognized as expense over the requisite performance periods, adjusted for subsequent changes in performance estimates. Compensation costs for components of equity-based awards subject to market-based performance metrics are measured at the dates of grant using Monte Carlo simulations which incorporate into the valuations the inherent uncertainty regarding achieving the market-based performance metrics. These initial valuation amounts are recognized as expense over the requisite performance periods, subject to adjustments only for actual forfeitures.

Income Taxes

Capstead Mortgage Corporation and its qualified REIT subsidiaries have elected to be taxed as a REIT. As a result, Capstead is not taxed on taxable income distributed to stockholders if certain REIT qualification tests are met. Capstead's policy is to distribute 100% of its taxable income, after application of available tax attributes, within the time limits prescribed by the Internal Revenue Code (the "Code"), which may extend into the subsequent taxable year. The Company may find it advantageous from time to

time to elect taxable REIT subsidiary status for certain of its subsidiaries in which case taxable income of any such subsidiary would be subject to federal and, where applicable, state or local income taxes. Any such income taxes are accounted for using the liability method. Related deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company has not recognized any liabilities for unrecognized tax benefits using a “more likely than not” threshold for the recognition and measurement of the financial statement effects of tax positions taken on a tax return filing. Should any such liabilities be recognized in future periods, the Company will record related interest and penalties in *Other general and administrative expense*.

Dividend Classification

The tax and financial reporting classification of dividends can differ primarily as a result of differences between taxable income attributable to a particular tax year and that year’s *Net income (loss)*, the amount and timing of dividends paid relative to taxable income and how such taxable income is allocated to dividends paid.

NOTE 3 — NET INCOME (LOSS) PER COMMON SHARE

Basic net income (loss) per common share is computed by dividing net (loss) income, after deducting dividends paid or accrued on preferred stock and allocating earnings to equity awards deemed to be participating securities pursuant to the two-class method, by the average number of shares of common stock outstanding, calculated excluding unvested stock awards. Participating securities include unvested equity awards that contain non-forfeitable rights to dividends prior to vesting.

Diluted net income (loss) per common share is computed by dividing the numerator used to compute basic net income (loss) per common share by the denominator used to compute basic net income (loss) per common share, further adjusted for the dilutive effect, if any, of equity awards and shares of preferred stock when and if convertible into shares of common stock. Shares of the Company's 7.50% Series E Cumulative Redeemable Preferred Stock are contingently convertible into shares of common stock only upon the occurrence of a change in control and subject to the conditions set forth in our charter and therefore are not considered dilutive securities absent such an occurrence. Any unvested equity awards that are deemed participating securities are included in the calculation of diluted net income (loss) per common share, if dilutive, under either the two-class method or the treasury stock method, depending upon which method produces the more dilutive result. The following table illustrates the computation of basic and diluted net income (loss) per common share for the indicated periods (dollars in thousands, except per share amounts).

| | <i>Year ended December 31</i> | | |
|---|-------------------------------|-------------|-------------|
| | <i>2020</i> | <i>2019</i> | <i>2018</i> |
| <i>Basic net income (loss) per common share</i> | | | |
| Numerator for basic net income (loss) per common share: | | | |
| Net (loss) income | \$ (129,573) | \$ (35,338) | \$ 50,072 |
| Preferred stock dividends | (19,368) | (19,368) | (19,368) |
| Earnings participation of unvested equity awards | (137) | (100) | (102) |
| | \$ (149,078) | \$ (54,806) | \$ 30,602 |
| Denominator for basic net income (loss) per common share: | | | |
| Average number of shares of common stock outstanding | 96,242 | 89,349 | 91,565 |
| Average unvested stock awards outstanding | (750) | (627) | (451) |
| | 95,492 | 88,722 | 91,114 |
| | \$ (1.56) | \$ (0.62) | \$ 0.34 |
| <i>Diluted net income (loss) per common share</i> | | | |
| Numerator for basic net income (loss) per common share | \$ (149,078) | \$ (54,806) | \$ 30,602 |
| Denominator for basic net income (loss) per common share | 95,492 | 88,722 | 91,114 |
| Net effect of dilutive equity awards | - | - | 116 |
| | 95,492 | 88,722 | 91,230 |
| | \$ (1.56) | \$ (0.62) | \$ 0.34 |

Anti-dilutive securities that could be potentially dilutive in the future that were not included in the computation of diluted net income (loss) per common share include equity awards for 902,000 and 947,000 shares of common stock excludable under the treasury stock method for years ended December 31, 2020 and 2019, respectively. There were no potentially dilutive securities excluded from the computation of year ended December 31, 2018.

NOTE 4 — RESIDENTIAL MORTGAGE INVESTMENTS

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

| | <i>Unpaid Principal Balance</i> | <i>Investment Premiums</i> | <i>Amortized Cost Basis</i> | <i>Carrying Amount (a)</i> | <i>Net WAC (b)</i> | <i>Average Yield (b)</i> |
|--------------------------|---|--------------------------------|---------------------------------|--------------------------------|------------------------|------------------------------|
| December 31, 2020 | | | | | | |
| Agency Securities: | | | | | | |
| Fannie Mae/Freddie Mac | | | | | | |
| ARMs | \$ 6,982,650 | \$ 252,921 | \$ 7,235,571 | \$ 7,310,089 | 2.67% | 2.14% |
| Ginnie Mae ARMAs | 599,726 | 17,704 | 617,430 | 627,463 | 3.39 | 1.80 |
| | <u>\$ 7,582,376</u> | <u>\$ 270,625</u> | <u>\$ 7,853,001</u> | <u>\$ 7,937,552</u> | 2.73 | 2.10 |
| December 31, 2019 | | | | | | |
| Agency Securities: | | | | | | |
| Fannie Mae/Freddie Mac | | | | | | |
| ARMs | \$ 8,628,739 | \$ 262,293 | \$ 8,891,032 | \$ 8,931,872 | 3.45% | 2.72% |
| Ginnie Mae ARMAs | 2,214,447 | 69,884 | 2,284,331 | 2,288,758 | 3.53 | 2.85 |
| | <u>\$ 10,843,186</u> | <u>\$ 332,177</u> | <u>\$ 11,175,363</u> | <u>\$ 11,220,630</u> | 3.46 | 2.75 |

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

(b) Net WAC, or weighted average coupon, is the weighted average interest rate of the mortgage loans underlying the indicated investments net of servicing and other fees as of the indicated balance sheet date. Net WAC is expressed as a percentage calculated on an annualized basis on the unpaid principal balances of the mortgage loans underlying these investments.

(c) Average yield is presented for the year then ended, and is based on the cash component of interest income expressed as a percentage on average amortized cost basis (the "cash yield") less the effects of amortizing investment premiums. Investment premium amortization is determined using the interest method and incorporates actual and anticipated future mortgage prepayments.

Agency Securities are considered to have limited, if any, credit risk because the timely payment of principal and interest is guaranteed. The maturity of Agency Securities is directly affected by prepayments of principal on the underlying mortgage loans. Consequently, actual maturities will be significantly shorter than the portfolio's weighted average contractual maturity of 292 months.

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

Capstead classifies its ARM investments based on average number of months until coupon reset ("months to roll"). Months to roll is an indicator of asset duration which is a measure of market price sensitivity to interest rate movements. A shorter duration generally indicates less interest rate risk. Current-reset ARM investments have months to roll of less than 18 months while longer-to-reset ARM investments have months to roll of 18 months or greater. As of December 31, 2020, the average months to roll for the Company's \$2.9 billion (amortized cost basis) in current-reset ARM investments was 6.3 months while the average months to roll for the Company's \$5.0 billion (amortized cost basis) in longer-to-reset ARM investments was 56.2 months.

During 2020 and 2019, the Company sold available-for-sale securities using the specific identification method for proceeds totaling \$2.56 billion and \$304.7 million recognizing zero and \$405,000 in gross realized gains and \$67.8 million and \$1.8 million in gross realized losses. The Company did not sell any securities during 2018.

NOTE 5 — SECURED BORROWINGS

Capstead pledges its *Residential mortgage investments* as collateral for secured borrowings primarily in the form of repurchase arrangements with commercial banks and other financial institutions. Repurchase arrangements entered into by the Company involve the sale and a simultaneous agreement to repurchase the transferred assets at a future date and are accounted for as financings. The Company maintains the beneficial interest in the specific securities pledged during the term of each repurchase arrangement and receives the related principal and interest payments.

The terms and conditions of secured borrowings are negotiated on a transaction-by-transaction basis when each such borrowing is initiated or renewed. The amount borrowed is generally equal to the fair value of the securities pledged, as determined by the lending counterparty, less an agreed-upon discount, referred to as a “haircut.” Interest rates are generally fixed based on prevailing rates corresponding to the terms of the borrowings. Interest may be paid monthly or at the termination of a borrowing at which time the Company may enter into a new borrowing at prevailing haircuts and rates with the same lending counterparty or repay that counterparty and negotiate financing with a different lending counterparty. None of the Company’s lending counterparties are obligated to renew or otherwise enter into new borrowings at the conclusion of existing borrowings. In response to declines in fair value of pledged securities due to changes in market conditions or the publishing of monthly security pay-down factors, lending counterparties typically require the Company to post additional securities as collateral, pay down borrowings or fund cash margin accounts with the counterparties in order to re-establish the agreed-upon collateral requirements. These actions are referred to as margin calls. Conversely, in response to increases in fair value of pledged securities, the Company routinely margin calls its lending counterparties in order to have previously pledged collateral returned.

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

| <i>Collateral Type</i> | <i>Collateral Carrying Amount</i> | <i>Accrued Interest Receivable</i> | <i>Borrowings Outstanding</i> | <i>Average Borrowing Rates</i> |
|--|---|--|-----------------------------------|--|
| <i>December 31, 2020</i> | | | | |
| Borrowings under repurchase arrangements secured by Agency securities with maturities of 30 days or less | \$ 5,249,989 | \$ 12,597 | \$ 4,972,181 | 0.21% |
| Borrowings under repurchase arrangements secured by Agency securities with maturities of 31 to 90 days | 1,939,034 | 4,225 | 1,846,902 | 0.20 |
| Borrowings under repurchase arrangements secured by Agency securities with maturities greater than 90 days | 522,969 | 1,167 | 500,000 | 0.29 |
| | <u>\$ 7,711,992</u> | <u>\$ 17,989</u> | <u>\$ 7,319,083</u> | 0.21 |
| <i>December 31, 2019</i> | | | | |
| Borrowings under repurchase arrangements secured by Agency securities with maturities of 30 days or less | \$ 9,484,275 | \$ 27,826 | \$ 9,002,527 | 2.12% |
| Borrowings under repurchase arrangements secured by Agency securities with maturities of 31 to 90 days | 1,344,437 | 3,742 | 1,271,971 | 1.98 |
| | <u>\$ 10,828,712</u> | <u>\$ 31,568</u> | <u>\$ 10,274,498</u> | 2.10 |

Average secured borrowings outstanding were \$8.21 billion and \$10.8 billion during 2020 and 2019, respectively. Average secured borrowings outstanding differed from respective year-end balances during the indicated periods primarily due to changes in portfolio levels and differences in the timing of portfolio acquisitions relative to portfolio runoff and asset sales. Interest paid on *Secured borrowings*, including related Derivative cash flows, totaled \$105.0 million, \$232.2 million, \$213.7 million and million during 2020, 2019, and 2018, respectively.

NOTE 6 — USE OF DERIVATIVES, OFFSETTING DISCLOSURES AND CHANGES IN OTHER COMPREHENSIVE INCOME BY COMPONENT

Capstead’s portfolio of Derivatives hedge the variability of the underlying benchmark interest rate of current and forecasted 30- to 90-day secured borrowings. The Company attempts to mitigate exposure to higher interest rates primarily by entering into pay-fixed, receive-variable, interest rate swap agreements for terms between eighteen months and three years. From an economic perspective, this hedge relationship establishes a relatively stable fixed rate on related borrowings because the variable-rate payments received on the swap agreements offset a significant portion of the interest accruing on the borrowings, leaving the fixed-rate swap payments as the Company’s effective borrowing rate, subject to certain adjustments. Additionally, changes in fair value of these Derivatives tend to offset opposing changes in fair value of the Company’s residential mortgage investments that can occur in response to changes in market interest rates.

The Company discontinued hedge accounting in March 2019 for its secured borrowings-related interest rate swaps and, for GAAP purposes, related changes in fair value are recorded in the Company’s consolidated statements of operations beginning on the de-designation date. Also, for GAAP purposes related net unrealized gains recorded in *Accumulated other comprehensive income* through the de-designation date are being recognized as a component of interest expense in the Company’s consolidated statements of operations over the contractual terms of these swaps.

During 2020 Capstead entered into swap agreements with notional amounts totaling \$5.77 billion requiring fixed-rate interest payments averaging 0.57% for periods between eighteen months and three years commencing on various dates between January 2020 and December 2020. During 2020, \$800 million notional amount of swaps requiring fixed-rate interest payments averaging 2.20% matured. The Company also terminated \$9.40 billion notional amount of swaps requiring fixed-rate interest payments averaging 1.54% during 2020. At December 31, 2020, the Company’s portfolio financing-related swap positions, all of which were either SOFR- or OIS-indexed, had the following characteristics (dollars in thousands):

| <i>Period of Contract Expiration</i> | <i>Swap Notional Amounts</i> | <i>Average Fixed Rates</i> |
|--------------------------------------|------------------------------|----------------------------|
| Second quarter 2022 | \$ 400,000 | 0.02% |
| Third quarter 2022 | 1,200,000 | 0.01 |
| Fourth quarter 2022 | 900,000 | 0.07 |
| Third quarter 2023 | 100,000 | 0.03 |
| Fourth quarter 2023 | 374,500 | 0.09 |
| | \$ 2,974,500 | |

The Company has three-month LIBOR-indexed, pay-fixed, receive-variable, interest rate swap agreements with notional amounts totaling \$100 million and average fixed rates of 4.09% with 20-year payment terms coinciding with the floating-rate terms of the Company’s *Unsecured borrowings* that mature in 2035 and 2036. These Derivatives, which are designated as cash flow hedges for accounting purposes, hedge the variability of the underlying benchmark interest rate associated with the floating-rate terms of these long-term borrowings. These Derivatives’ LIBOR-indexed receive rates match the underlying floating-rate terms of the Company’s *Unsecured borrowings* and therefore the eventual replacement of the LIBOR index on these Derivatives is not expected to have any financial impact.

Interest rate swap agreements are measured at fair value on a recurring basis primarily using Level Two Inputs in accordance with ASU 2010-06, *Fair Value Measurements and Disclosures (Topic 820)*. In determining fair value estimates for swaps, Capstead utilizes the standard methodology of netting the discounted future fixed cash payments and the discounted future variable cash receipts which are based on expected future interest rates derived from observable market interest rate curves. Eurodollar futures are measured at fair value using Level 1 inputs based on quoted exchange prices on these contracts. The

Company also incorporates both its own nonperformance risk and its counterparties' nonperformance risk in determining fair value. In considering the effect of nonperformance risk, the Company considered the impact of netting and credit enhancements, such as collateral postings and guarantees, and has concluded that counterparty risk is not significant to the overall valuation.

The fair value of exchange-traded swap agreements hedging *Secured borrowings* is calculated including accrued interest and net of variation margin amounts received or paid through the exchange, resulting in separately presenting on the balance sheet a fair value amount representing the unsettled fair value of these Derivatives. Non-exchange traded swap agreements held as cash flow hedges of *Unsecured borrowings* are reported at fair value calculated excluding accrued interest. At December 31, 2020, *Cash collateral receivable from derivative counterparties* includes initial margin for all Derivatives and variation margin for non-exchange traded Derivatives. Accrued interest for non-exchange traded swap agreements is included in *Accounts payable and accrued expenses*.

The following tables include fair value and other related disclosures regarding all Derivatives held as of and for the indicated periods (in thousands):

| | <i>Balance Sheet Location</i> | <i>December 31</i> | |
|--|-----------------------------------|--------------------|--------------------|
| | | <i>2020</i> | <i>2019</i> |
| <i>Balance sheet-related</i> | | | |
| Swap agreements in a gain position (an asset) related to secured borrowings | (a) | \$ — | \$ 733 |
| Eurodollar futures contracts in a gain position | (a) | — | 738 |
| Swap agreements in a loss position (a liability) related to unsecured borrowings | (a) | (41,484) | (29,156) |
| Related net interest payable | (b) | (597) | (437) |
| | | <u>\$ (42,081)</u> | <u>\$ (28,122)</u> |

(a) *The fair value of Derivatives with unrealized gains are aggregated and recorded as an asset on the face of the Balance Sheets separately from the fair value of Derivatives with unrealized losses that are recorded as a liability.*

(b) *Included in "Accounts payable and accrued expenses" on the face of the Balance Sheets.*

| | <i>Location of Gain or (Loss) Recognized in Net (Loss) Income</i> | <i>Year ended December 31</i> | | |
|---|---|-------------------------------|--------------------|------------------|
| | | <i>2020</i> | <i>2019</i> | <i>2018</i> |
| <i>Income statement-related</i> | | | | |
| Components of Secured borrowings-related effects on interest expense: | | | | |
| Amount of gain reclassified from <i>Accumulated other comprehensive income</i> | | \$ — | \$ 7,891 | \$ 38,292 |
| Amount of unrealized gain, net of unrealized losses on de-designated Derivatives | | (529) | 14,712 | — |
| | (a) | <u>(529)</u> | <u>22,603</u> | <u>38,292</u> |
| Component of Unsecured borrowings-related effects on interest expense: | | | | |
| Amount of loss reclassified from <i>Accumulated other comprehensive income</i> | (b) | <u>(3,293)</u> | <u>(1,616)</u> | <u>(1,902)</u> |
| (Increase) decrease in interest expense as a result of the use of Derivatives | | <u>\$ (3,822)</u> | <u>\$ 20,987</u> | <u>\$ 36,390</u> |
| Realized and unrealized (loss) gain on non-designated Derivatives (net) related to: | | | | |
| Interest rate swap agreements | | \$ (156,748) | \$ (91,791) | \$ — |
| Eurodollar futures | | (2,799) | 1,213 | — |
| | (c) | <u>\$ (159,547)</u> | <u>\$ (90,578)</u> | <u>\$ —</u> |
| <i>Other comprehensive income-related</i> | | | | |
| Amount of (loss) gain recognized in <i>Other comprehensive income (loss)</i> | | <u>\$ (15,621)</u> | <u>\$ (17,080)</u> | <u>\$ 25,716</u> |

(a) Included in "Interest expense: Secured borrowings" on the face of the Statements of Operations.

(b) Included in "Interest expense: Unsecured borrowings" on the face of the Statements of Operations.

(c) Included in "Loss on derivative instruments (net)" on the face of the Statement of Operations.

Capstead's swap agreements and borrowings under repurchase arrangements are subject to master netting arrangements in the event of default on, or termination of, any one contract. See NOTE 5 for more information on the Company's use of secured borrowings. The following tables provide further details concerning offsetting of financial liabilities and Derivatives as of the indicated dates (in thousands):

| | <i>Offsetting of Derivative Assets</i> | | | | | |
|---------------------------------|---|--|---|--|---|-----------------------|
| | <i>Gross Amounts of Recognized Assets (a)</i> | <i>Gross Amounts Offset in the Balance Sheet (a)</i> | <i>Net Amounts of Assets Presented in the Balance Sheet</i> | <i>Gross Amounts Not Offset in the Balance Sheet (b)</i> | | |
| | | | | <i>Financial Instruments</i> | <i>Cash Collateral Received</i> | <i>Net Amount</i> |
| <i>December 31, 2020</i> | | | | | | |
| Counterparty 4 | <u>\$ 2,673</u> | <u>\$ (2,673)</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> |
| <i>December 31, 2019</i> | | | | | | |
| Counterparty 4 | <u>\$ 6,517</u> | <u>\$ (5,046)</u> | <u>\$ 1,471</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 1,471</u> |

(a) Included in gross amounts of recognized assets at December 31, 2020 is the fair value of exchange-traded swap agreements, calculated including accrued interest. Included in gross amounts offset in the balance sheet are variation margin amounts associated with these swaps at December 31, 2020.

(b) Amounts presented are limited to recognized liabilities and cash collateral received associated with the indicated counterparty sufficient to reduce the related Net Amount to zero in accordance with ASU No. 2011-11, as amended by ASU No. 2013-01.

| Offsetting of Financial Liabilities and Derivative Liabilities | | | | | | |
|---|--|---|---|---|--|-----------------------|
| | Gross Amounts of Recognized Liabilities^(a) | Gross Amounts Offset in the Balance Sheet ^(a) | Net Amounts of Liabilities Presented in the Balance Sheet ^(b) | Gross Amounts Not Offset in the Balance Sheet ^(c) | | Net Amount |
| | | | | Financial Instruments | Cash Collateral Pledged | |
| December 31, 2020 | | | | | | |
| Derivatives by counterparty: | | | | | | |
| Counterparty 1 | \$ 42,082 | \$ — | \$ 42,082 | \$ — | \$ (42,082) | \$ — |
| Counterparty 4 | 257 | (257) | — | — | — | — |
| | <u>42,339</u> | <u>(257)</u> | <u>42,082</u> | <u>—</u> | <u>(42,082)</u> | <u>—</u> |
| Borrowings under repurchase arrangements (d) | 7,320,090 | — | 7,320,090 | (7,320,090) | — | — |
| | <u>\$ 7,362,429</u> | <u>\$ (257)</u> | <u>\$ 7,362,172</u> | <u>\$ (7,320,090)</u> | <u>\$ (42,082)</u> | <u>\$ —</u> |
| December 31, 2019 | | | | | | |
| Derivatives by counterparty: | | | | | | |
| Counterparty 1 | \$ 29,593 | \$ — | \$ 29,593 | \$ — | \$ (29,593) | \$ — |
| Counterparty 4 | 21,601 | (21,601) | — | — | — | — |
| | <u>51,194</u> | <u>(21,601)</u> | <u>29,593</u> | <u>—</u> | <u>(29,593)</u> | <u>—</u> |
| Borrowings under repurchase arrangements (d) | 10,286,011 | — | 10,286,011 | (10,286,011) | — | — |
| | <u>\$ 10,337,205</u> | <u>\$ (21,601)</u> | <u>\$ 10,315,604</u> | <u>\$ (10,286,011)</u> | <u>\$ (29,593)</u> | <u>\$ —</u> |

(a) Included in gross amounts of recognized liabilities at December 31, 2020 is the fair value of non-exchange traded swap agreements (Counterparty 1) and exchange-traded swap agreements (Counterparty 4), calculated including accrued interest. Included in gross amounts offset in the balance sheet are variation margin amounts associated with exchange-traded swap agreements at December 31, 2020.

(b) Amounts presented are limited to recognized liabilities and cash collateral received associated with the indicated counterparty sufficient to reduce the related Net Amount to zero in accordance with ASU No. 2011-11, as amended by ASU No. 2013-01.

(c) Amounts presented are limited to recognized assets and collateral pledged associated with the indicated counterparty sufficient to reduce the related Net Amount to zero in accordance with ASU No. 2011-11, as amended by ASU No. 2013-01.

(d) Amounts include accrued interest payable of \$1.0 million and \$11.5 million on borrowings under repurchases arrangements as of December 31, 2020 and December 31, 2019, respectively.

The amount of unrealized losses, net of unrealized gains, included in *Accumulated other comprehensive income* scheduled to be recognized in the Statements of Operations over the next twelve months primarily in the form of fixed-rate swap payments in excess of current market rates on swaps related to unsecured borrowings and amortization of net unrealized losses on de-designated interest rate swaps totaled \$6.1 million at December 31, 2020. Changes in *Accumulated other comprehensive income* by component for the three years ended December 31, 2020 were as follows (in thousands):

| | <i>Unrealized Gains and Losses on Cash Flow Hedges</i> | <i>Unrealized Gains and Losses on Available-for-Sale Securities</i> | <i>Total</i> |
|--|--|---|--------------|
| Balance at December 31, 2017 | \$ 16,874 | \$ 45,244 | \$ 62,118 |
| Activity for the year ended December 31, 2018: | | | |
| Other comprehensive income (loss) before reclassifications | 25,716 | (72,490) | (46,774) |
| Amounts reclassified from accumulated other comprehensive income | (36,390) | — | (36,390) |
| Other comprehensive loss | (10,674) | (72,490) | (83,164) |
| Balance at December 31, 2018 | 6,200 | (27,246) | (21,046) |
| Activity for the year ended December 31, 2019: | | | |
| Other comprehensive (loss) income before reclassifications | (17,080) | 71,148 | 54,068 |
| Amounts reclassified from accumulated other comprehensive income | (20,988) | 1,365 | (19,623) |
| Other comprehensive (loss) income | (38,068) | 72,513 | 34,445 |
| Balance at December 31, 2019 | (31,868) | 45,267 | 13,399 |
| Activity for the year ended December 31, 2020: | | | |
| Other comprehensive loss before reclassifications | (15,621) | (27,580) | (43,201) |
| Amounts reclassified from accumulated other comprehensive income | 3,822 | 66,864 | 70,686 |
| Other comprehensive (loss) income | (11,799) | 39,284 | 27,485 |
| Balance at December 31, 2020 | \$ (43,667) | \$ 84,551 | \$ 40,884 |

NOTE 7 — UNSECURED BORROWINGS

Unsecured borrowings consist of 30-year junior subordinated notes issued in 2005 and 2006 and maturing in 2035 and 2036, for a total face amount of \$100 million. Note balances net of deferred issuance costs, and related weighted average interest rates as of the indicated dates (calculated including issuance cost amortization and adjusted for the effects of related Derivatives held as cash flow hedges) were as follows (dollars in thousands):

| | <i>December 31, 2020</i> | | <i>December 31, 2019</i> | |
|--|-----------------------------------|-------------------------|-----------------------------------|-------------------------|
| | <i>Borrowings Outstanding</i> | <i>Average Rate</i> | <i>Borrowings Outstanding</i> | <i>Average Rate</i> |
| Junior subordinated notes maturing in: | | | | |
| October 2035 (\$35,000 face amount) | \$ 34,431 | 7.87% | \$ 34,392 | 7.88% |
| December 2035 (\$40,000 face amount) | 39,435 | 7.64 | 39,397 | 7.64 |
| September 2036 (\$25,000 face amount) | 24,627 | 7.68 | 24,603 | 7.68 |
| | <u>\$ 98,493</u> | 7.73 | <u>\$ 98,392</u> | 7.73 |

The notes are currently redeemable, in whole or in part, without penalty, at the Company's option. Interest paid on *Unsecured borrowings*, including related Derivative cash flows, totaled \$7.5 million during 2020, 2019 and 2018, respectively.

NOTE 8 — FAIR VALUES OF FINANCIAL INSTRUMENTS

The fair value of Capstead's financial assets and liabilities are influenced by changes in, and market expectations for changes in, interest rates and market liquidity conditions, as well as other factors beyond the control of management. With the exception of the fair value of Eurodollar futures, all fair values were determined using Level 2 Inputs in accordance with ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820). Eurodollar futures are Derivatives for which Level 1 inputs are used to determine fair value.

Residential mortgage investments, all of which are mortgage securities classified as available-for-sale, are measured at fair value on a recurring basis. In determining fair value estimates the Company considers recent trading activity for similar investments and pricing levels indicated by lenders in connection with designating collateral for secured borrowings, provided such pricing levels are considered indicative of actual market clearing transactions. The Company currently bases fair value for *Unsecured borrowings* on discounted cash flows using Company estimates for market yields. Excluded from these disclosures are financial instruments for which cost basis is deemed to approximate fair value due primarily to the short duration of these instruments, which are valued using primarily Level 1 measurements, including *Cash and cash equivalents*, *Cash collateral receivable from derivative counterparties*, receivables, payables and *Secured borrowings* with initial terms of 120 days or less. See NOTE 6 for information relative to the valuation of interest rate swap agreements.

The following table presents the fair value for the Company's financial instruments as of the indicated dates (in thousands):

| | <i>Fair Value Hierarchy</i> | <i>December 31, 2020</i> | | <i>December 31, 2019</i> | |
|--|-----------------------------|--------------------------|-------------------|--------------------------|-------------------|
| | | <i>Carrying Amount</i> | <i>Fair Value</i> | <i>Carrying Amount</i> | <i>Fair Value</i> |
| Financial assets: | | | | | |
| Secured borrowings-related interest rate swap agreements | Level 2 | \$ — | \$ — | \$ 733 | \$ 733 |
| Eurodollar futures | Level 1 | — | — | 738 | 738 |
| Financial liabilities: | | | | | |
| Secured borrowings with initial terms of greater than 120 days | Level 2 | 500,000 | 500,100 | — | — |
| Unsecured borrowings | Level 2 | 98,493 | 59,900 | 98,392 | 68,100 |
| Unsecured borrowings-related interest rate swap agreements | Level 2 | 41,484 | 41,484 | 29,156 | 29,156 |

Fair value-related disclosures for debt securities were as follows as of the indicated dates (in thousands):

| | <i>Amortized Cost Basis</i> | <i>Gross Unrealized</i> | | <i>Fair Value</i> |
|--|---------------------------------|----------------------------|--------------------------|----------------------------|
| | | <i>Gains</i> | <i>Losses</i> | |
| December 31, 2020 | | | | |
| Agency Securities classified as available-for-sale: | | | | |
| Fannie Mae/Freddie Mac | \$ 7,235,571 | \$ 87,158 | \$ 12,640 | \$ 7,310,089 |
| Ginnie Mae | 617,430 | 10,541 | 508 | 627,463 |
| December 31, 2019 | | | | |
| Agency Securities classified as available-for-sale: | | | | |
| Fannie Mae/Freddie Mac | 8,890,949 | 64,593 | 23,753 | 8,931,789 |
| Ginnie Mae | 2,284,331 | 11,560 | 7,133 | 2,288,758 |
| | <i>December 31, 2020</i> | | <i>December 31, 2019</i> | |
| | <i>Fair Value</i> | <i>Unrealized Loss</i> | <i>Fair Value</i> | <i>Unrealized Loss</i> |
| Securities in an unrealized loss position of one year or greater: | | | | |
| Fannie Mae/Freddie Mac | \$ 690,227 | \$ 9,533 | \$ 2,030,192 | \$ 17,069 |
| Ginnie Mae | 27,462 | 285 | 560,022 | 5,775 |
| Securities in an unrealized loss position of less than one year: | | | | |
| Fannie Mae/Freddie Mac | 583,870 | 3,107 | 1,473,144 | 6,684 |
| Ginnie Mae | 41,527 | 223 | 416,888 | 1,358 |
| | <u>\$ 1,343,086</u> | <u>\$ 13,148</u> | <u>\$ 4,480,246</u> | <u>\$ 30,886</u> |

From a credit risk perspective, federal government support for Fannie Mae and Freddie Mac helps ensure that fluctuations in value are due to interest rate changes and are not due to credit risk associated with these securities. The unrealized losses on the Company's investment in Agency Securities were caused by interest rate changes, and the contractual cash flows of those investments are guaranteed by an agency of the U.S. government. The Company does not intend to sell the investments as of December 31, 2020 and it is not more likely than not that the Company will be required to sell the investments before recovering their related amortized cost bases.

NOTE 9 — INCOME TAXES

Capstead and a subsidiary for which the Company has elected taxable REIT subsidiary status file separate tax returns in U.S. federal and state jurisdictions, where applicable. Provided Capstead remains qualified as a REIT and all its taxable income is distributed to stockholders within allowable time limits, no income taxes are due on this income. Accordingly, no provision has been made for income taxes for Capstead. Taxable income, if any, of the Company's largely dormant taxable REIT subsidiary is fully taxable and provision is made for any resulting income taxes. The Company is no longer subject to examination and the related assessment of tax by federal, state, or local tax authorities for years before 2017.

For tax years after 2017, the Tax Cuts and Jobs Act ("Tax Act") repealed the corporate Alternative Minimum Tax ("AMT"). AMT credit carryforwards became fully utilizable without limitation or, in the absence of regular tax liability, fully refundable over the ensuing four years. Accordingly, in 2017 the Company's taxable REIT subsidiary recognized a refund of AMT under the Tax Act and recorded a receivable in *Receivables and other assets*, which was collected in full in 2020 under the provisions of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") of 2020.

Additionally, the CARES Act modified the rules for REIT net operating losses ("NOL"). A REIT NOL carryover can now only offset 80% of taxable income for losses arising in years beginning after December 31, 2020. The 80% limitation is calculated by multiplying current-year REIT taxable income

before the dividends paid deduction by 80%. For tax years beginning before January 1, 2021, a taxpayer can offset 100% of its income in any given year with an NOL. Although there will be an annual NOL limitation for tax years starting after December 31, 2020, the Tax Act allows post-2017 NOLs to be carried forward indefinitely. At December 31, 2020 Capstead had an NOL of \$90 million that does not expire.

The Company's effective tax rate differs substantially from statutory federal income tax rates primarily due to the benefit of Capstead's status as a REIT, along with other items affecting the Company's effective tax rate as illustrated below for the indicated periods (in thousands):

| | <i>Year ended December 31</i> | | |
|--|-------------------------------|-------------|-------------|
| | <i>2020</i> | <i>2019</i> | <i>2018</i> |
| Income taxes computed at the federal statutory rate | \$ 2 | \$ 6 | \$ 10,515 |
| Benefit of REIT status | — | - | (10,512) |
| Income taxes computed on income of the Company's taxable REIT subsidiary | 2 | 6 | 3 |
| Other change in net deferred income tax assets | (2) | (6) | (3) |
| Income tax (benefit) provision recorded in miscellaneous other revenue (expense) | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> |

No income taxes were paid during 2020, 2019 or 2018. Capstead had \$17.5 million in net capital loss carryforwards that expired at the end of 2019. At December 31, 2020 Capstead has \$68.2 million in net capital loss carryforwards that if unused, expire at the end of 2025. Significant components of the Company's taxable REIT subsidiary's deferred income tax assets and liabilities were as follows as of the indicated dates (in thousands):

| | <i>December 31</i> | |
|--------------------------------------|--------------------|--------------|
| | <i>2020</i> | <i>2019</i> |
| Deferred income tax assets: | | |
| Net operating loss carryforwards (a) | \$ 71 | \$ 24 |
| Other | 9 | 10 |
| | <u>80</u> | <u>34</u> |
| Deferred income tax liabilities | — | — |
| Net deferred tax assets | <u>\$ 80</u> | <u>\$ 34</u> |
| Valuation allowance (b) | <u>\$ 80</u> | <u>\$ 34</u> |

(a) The increase in net operating loss carryforward from 2019 to 2020 is due to a carryforward correction noted in reconciliation against filed tax returns.

(b) Because this subsidiary is not expected to earn significant amounts of taxable income, related net deferred tax assets are fully reserved at December 31, 2020.

NOTE 10 — STOCKHOLDERS' EQUITY

In February 2020, the Company issued 1.6 million shares of common stock through an at-the-market continuous offering program at an average price of \$8.21, net of fees and other costs, for net proceeds of \$12.9 million. On August 1, 2019 the Company completed a public offering for nine million shares of common stock raising \$75.1 million at a net price of \$8.34 per share after underwriting discounts and offering expenses. The proceeds were deployed into additional ARM Agency Securities and used for general corporate purposes. Additional amounts of equity capital may be raised in the future under continuous offering programs or by other means, subject to market conditions, compliance with federal securities laws and blackout periods.

In 2019 Capstead's Board of Directors increased its 2017 common stock repurchase program authorization to \$125 million, leaving a remaining repurchase program authorization of approximately \$37 million. The Company did not repurchase shares in 2020 or 2019. During 2018, the Company repurchased 10.7 million shares for an average net repurchase price of \$7.94 for a total capital deployment of \$84.6 million.

During 2020, 2019 and 2018, additions to common equity capital related to equity-based awards to directors and employees totaled \$3.1 million, \$2.6 million and \$1.7 million, respectively. See NOTE 11 for further information pertaining to long-term equity-based awards.

At December 31, 2020 and 2019, the Company had issued and outstanding 10.3 million shares of its 7.50% Series E Cumulative Redeemable Preferred Stock. Shares of the Series E preferred stock are redeemable at the Company's option for \$25.00 per share, plus any accumulated and unpaid dividends and have a liquidation preference of \$25.00 per share. The Company issued no Series E preferred stock in 2020, 2019 or 2018.

NOTE 11 — EQUITY INCENTIVE PLAN

All equity-based awards and other long-term incentive awards are made pursuant to the Company's Amended and Restated 2014 Flexible Incentive Plan that was approved by stockholders in May 2014. At December 31, 2020, this plan had 2,454,061 shares of common stock remaining available for future issuances.

Long-term equity-based Awards – Performance-based Restricted Stock Units ("RSUs")

A summary of the Company's restricted stock unit activity and related information for the year ended December 31, 2020 is summarized below:

| | <i>Number of Shares</i> | <i>Weighted Average Grant Date Fair Value</i> |
|--|-----------------------------|---|
| Unvested RSU awards outstanding at December 31, 2019 | 538,945 | \$ 8.50 |
| Grants | 191,314 | 8.03 |
| Forfeitures | (148,894) | 10.52 |
| Unvested RSU awards outstanding at December 31, 2020 | <u>581,365</u> | 7.83 |

Dividends accrue from the date of grant and will be paid in cash to the extent the units convert into shares of common stock following completion of related performance periods. Unrecognized estimated compensation expense for these awards totaled \$1.3 million at December 31, 2020, to be expensed over a weighted average period of 1.4 years (assumes estimated attainment levels for the related performance metrics will be met).

Recognized in *Compensation-related expense* are \$932,000, \$771,000 and \$104,000 related to this program during 2020, 2019 and 2018, respectively. Included in *Common stock dividends payable* at

December 31, 2020 and 2019 are estimated dividends payable pertaining to these awards of \$354,000 and \$125,000, respectively.

Long-term equity-based Awards – Stock Awards

Stock award activity for the year ended December 31, 2020 is summarized below:

| | <i>Number of Shares</i> | <i>Weighted Average Grant Date Fair Value</i> |
|--|-----------------------------|---|
| Unvested stock awards outstanding at December 31, 2019 | 615,045 | \$ 8.14 |
| Grants | 322,744 | 7.39 |
| Vestings | <u>(169,748)</u> | 9.98 |
| Unvested stock awards outstanding at December 31, 2020 | <u>768,041</u> | 7.42 |

During 2020, 2019 and 2018, the Company recognized in *Compensation-related expense* \$1.7 million, \$1.4 million and \$1.2 million, respectively, related to amortization of the grant date fair value of employee stock awards. In addition, the Company recognized in *Other general and administrative expense* \$570,000, \$505,000 and \$450,000 related to amortization of the grant date fair value of director stock awards during 2020, 2019 and 2018, respectively. Unrecognized compensation expense for unvested stock awards totaled \$2.1 million as of December 31, 2020, to be expensed over a weighted average period of 1.3 years.

Service-based stock awards issued to directors and to non-executive employees receive dividends on a current basis without risk of forfeiture if the related awards do not vest. Stock awards issued to executives defer the payment of dividends accruing between the grant dates and the end of related performance or service periods. If these awards do not vest, the related accrued dividends will be forfeited. Included in *Common stock dividend payable* at December 31, 2020 and 2019 are estimated dividends payable pertaining to these awards totaling \$533,000 and \$350,000, respectively.

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

**Reports on Corporate Governance and
Report of Independent Registered Public Accounting Firm**

Report of Management on Effectiveness of Internal Control Over Financial Reporting

Management of Capstead is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a – 15(f) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Under the supervision and with the participation of management, including the Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), we conducted an evaluation of the effectiveness of the internal control over financial reporting based on the framework established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (“COSO”). Based on our evaluation under the COSO framework, it is management’s assessment that the Company maintained effective internal control over financial reporting as of December 31, 2020.

Capstead’s independent registered public accounting firm, Ernst & Young, LLP, has issued a report on the Company’s effectiveness of internal control over financial reporting as of December 31, 2020, which is included in this Annual Report.

Report of Management on Evaluation of Disclosure Controls and Procedures

Management of Capstead, with participation of the CEO and CFO, has evaluated the effectiveness of the Company’s disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities and Exchange Act of 1934, as of December 31, 2020. Based on this evaluation, the Company’s management, including the CEO and CFO, concluded that the Company’s disclosure controls and procedures were effective as of December 31, 2020.

Changes in Internal Control Over Financial Reporting

There has been no change in Capstead’s internal control over financial reporting as of December 31, 2020, that has materially affected, or is reasonably likely to materially affect, Capstead’s internal control over financial reporting.

Related Certifications by Management

Certifications by the CEO and CFO pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002 pertaining to the completeness and fairness of the information contained in Capstead’s annual report on Form 10-K for the year ended December 31, 2020 and the Company’s system of internal controls over financial reporting and disclosure controls and procedures are included as exhibits to the annual report on Form 10-K. This report, as well as the Company’s other filings with the Securities and Exchange Commission, are available free of charge on the Company’s website at www.capstead.com.

***Report of Independent Registered Public Accounting Firm on
Audit of Internal Control Over Financial Reporting***

To the Shareholders and the Board of Directors of Capstead Mortgage Corporation

Opinion on Internal Control over Financial Reporting

We have audited Capstead Mortgage Corporation's internal control over financial reporting as of December 31, 2020, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, Capstead Mortgage Corporation (the Company) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2020, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of Capstead Mortgage Corporation as of December 31, 2020 and 2019, the related consolidated statements of operations, comprehensive income (loss), stockholders' equity and cash flows for each of the three years in the period ended December 31, 2020, and the related notes and our report dated February 19, 2021 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's 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 Report of Management on Effectiveness of 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 are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. 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, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

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.

/s/ ERNST & YOUNG, LLP

Dallas, Texas
February 19, 2021

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The information required by this item is incorporated herein by reference to Capstead's 2021 definitive Proxy Statement under the captions "Proposal One – Election of Directors," "Board of Directors and Committee Information," "Stockholder Procedures for Director Candidate Recommendations," "Executive Officers," "Audit Committee" and "Audit Committee Report" and "Section 16(a) Beneficial Ownership Reporting Compliance," to be filed with the SEC within 120 days of year-end.

Capstead has adopted its Code of Business Conduct and Ethics that applies to all directors, officers and employees, and its Financial Officer Code of Conduct that applies to its chief executive officer, chief financial officer and other officers with a role in the Company's financial accounting and reporting process. These codes and waivers thereto, if any, are available on the Company's website at www.capstead.com.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated herein by reference to Capstead's 2021 definitive Proxy Statement under the captions "Board of Directors and Committee Information" and "Executive Compensation," to be filed with the SEC within 120 days of year-end.

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

The information required by this item is incorporated herein by reference to Capstead's 2021 definitive Proxy Statement under the captions "Equity Compensation Plans" and "Security Ownership of Management and Certain Beneficial Owners," to be filed with the SEC within 120 days of year-end.

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

The information required by this item is incorporated herein by reference to Capstead's 2021 definitive Proxy Statement under the caption "Related Person Transactions," to be filed with the SEC within 120 days of year-end.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is incorporated herein by reference to Capstead's 2021 definitive Proxy Statement under the caption "Proposal Three – Ratification of the Appointment of Ernst & Young LLP as Our Independent Registered Public Accounting Firm," to be filed with the SEC within 120 days of year-end.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report:

1. The consolidated financial statements of Capstead, together with the independent registered public accounting firm's report thereon, are set forth in this report under Item 8, "Financial Statements and Supplementary Data."
2. Financial Statement Schedules – All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are either not required under the related instructions, are inapplicable or have been omitted because the required information has been disclosed elsewhere in the consolidated financial statements and related notes thereto.
3. Exhibits:

| EXHIBIT NUMBER | DESCRIPTION |
|---------------------------|---|
| 3.1 | <u>Charter, including Articles of Incorporation, Articles Supplementary for each series of preferred shares no longer outstanding and all other amendments to such Articles of Incorporation.(1)</u> |
| 3.2 | <u>Articles Supplementary classifying and designating the Registrant's 7.50% Series E Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share, par value \$0.10 per share.(2)</u> |
| 3.3 | <u>Amended and Restated Bylaws.(3)</u> |
| 4.1 | <u>Specimen of Common Stock Certificate.(4)</u> |
| 4.2 | <u>Specimen of stock certificate evidencing the 7.50% Series E Cumulative Redeemable Preferred Stock of the Registrant, liquidation preference \$25.00 per share, par value \$0.10 per share.(2)</u> |
| 4.3 | <u>Junior Subordinated Indenture dated September 26, 2005.(5)</u> |
| 4.4 | <u>Indenture dated December 15, 2005.(5)</u> |
| 4.5 | <u>Indenture dated September 11, 2006.(5)</u> |
| 4.6 | <u>Description of Securities.(6)</u> |
| 10.01 | <u>Amended and Restated Deferred Compensation Plan.(7)</u> |
| 10.02 | <u>Amended and Restated 2014 Flexible Incentive Plan.(8)</u> |
| 10.03 | <u>Amendment No. 1 to the Amended and Restated 2014 Flexible Incentive Plan.(9)</u> |
| 10.04 | <u>Third Amended and Restated Incentive Bonus Plan.(7)</u> |
| 10.05 | <u>Form of nonqualified stock option and stock award agreements for non-employee directors.(5)</u> |
| 10.06 | <u>2018 Long-Term Performance Unit Award Criteria. (10)</u> |
| 10.07 | <u>Form of performance unit agreement for executive employees. (10)</u> |
| 10.08 | <u>2019 Annual Incentive Compensation Program. (11)</u> |
| 10.09 | <u>Form of restricted stock agreement for executive employees. (11)</u> |
| 10.10 | <u>2019 Long-Term Performance Unit Award Criteria. (11)</u> |
| 10.11 | <u>Form of performance unit agreement for executive employees. (11)</u> |
| 10.12 | <u>2020 Annual Incentive Compensation Program. (12)</u> |
| 10.13 | <u>Form of restricted stock agreement for executive employees. (12)</u> |
| 10.14 | <u>2020 Long-Term Performance Unit Award Criteria. (12)</u> |
| 10.15 | <u>Form of performance unit agreement for executive employees. (12)</u> |
| 10.16 | <u>2021 Annual Incentive Compensation Program. (13)</u> |
| 10.17 | <u>Form of restricted stock agreement for executive employees. (13)</u> |
| 10.18 | <u>2021 Long-Term Performance Unit Award Criteria. (13)</u> |
| 10.19 | <u>Form of performance unit agreement for executive employees. (13)</u> |

**EXHIBIT
NUMBER****DESCRIPTION**

| | |
|---------|---|
| 10.20 | Form of Change in Control/Severance Agreement for executive officers. (14) |
| 10.21 | Form of Equity Distribution Agreement, dated January 12, 2021. (15) |
| 23 | Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm* |
| 31.1 | Certification pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002* |
| 31.2 | Certification pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002* |
| 32.1 | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002** |
| 32.2 | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002** |
| 101.INS | Inline XBRL Instance Document – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.* |
| 101.SCH | Inline XBRL Taxonomy Extension Schema* |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation Linkbase* |
| 101.DEF | Inline XBRL Additional Taxonomy Extension Definition Linkbase* |
| 101.LAB | Inline XBRL Taxonomy Extension Label Linkbase* |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation Linkbase* |
| 104 | Cover Page Interactive Data File (embedded within the Inline XBRL document)* |

- (1) Incorporated by reference to the Registrant’s Annual Report on Form 10-K/A (No. 001-08896) for the year ended December 31, 2012.
(2) Incorporated by reference to the Registrant’s Registration of Certain Classes of Securities on Form 8-A (No. 001-08896) dated May 13, 2013.
(3) Incorporated by reference to the Registrant’s Current Report on Form 8-K (No. 001-08896), filed on February 3, 2014, for the event dated January 29, 2014.
(4) Incorporated by reference to the Registrant’s Registration Statement on Form S-3 (No. 333-63358) dated June 19, 2001.
(5) Incorporated by reference to the Registrant’s Annual Report on Form 10-K (No. 001-08896) for the year ended December 31, 2011.
(6) Incorporated by reference to the Registrant’s Annual Report on Form 10-K (No. 001-08896) for the year ended December 31, 2019.
(7) Incorporated by reference to the Registrant’s Quarterly Report on Form 10-Q (No. 001-08896) for the quarter ended June 30, 2019.
(8) Incorporated by reference to the Registrant’s Current Report on Form 8-K (No. 001-08896), filed on May 30, 2014, for the event dated May 28, 2014.
(9) Incorporated by reference to the Registrant’s Current Report on Form 8-K (No. 001-08896), filed on February 20, 2015, for the event dated February 20, 2015.
(10) Incorporated by reference to the Registrant’s Current Report on Form 8-K (No. 001-08896), filed on January 4, 2018, for the event dated January 3, 2018.
(11) Incorporated by reference to the Registrant’s Current Report on Form 8-K (No. 001-08896), filed on January 7, 2019, for the event dated January 3, 2019.
(12) Incorporated by reference to the Registrant’s Current Report on Form 8-K (No.001-08896), filed on January 3, 2020, for the event dated January 2, 2020.
(13) Incorporated by reference to the Registrant’s Current Report on Form 8-K (No.001-08896), filed on January 12, 2021, for the event dated January 8, 2021.
(14) Incorporated by reference to the Registrant’s Annual Report on Form 10-K (No. 001-08896) for the year ended December 31, 2017.
(15) Incorporated by reference to the Registrant’s Current Report on Form 8-K (No. 001-08896), filed on January 12, 2021, for the event dated January 12, 2021.
* Filed herewith
** Furnished herewith

SIGNATURES

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

CAPSTEAD MORTGAGE CORPORATION Registrant

Date: February 19, 2021

By: /s/ PHILLIP A. REINSCH
Phillip A. Reinsch
President and Chief Executive Officer

Date: February 19, 2021

By: /s/ LANCE J. PHILLIPS
Lance J. Phillips
Senior Vice President, Chief Financial Officer
and Secretary (Principal Financial and
Accounting 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 Company and in the capacities and on the dates indicated.

| | | |
|---|--|-------------------|
| <u>/s/ PAT AUGUSTINE</u> Pat Augustine | Director | February 16, 2021 |
| <u>/s/ JACK BIEGLER</u> Jack Biegler | Director | February 16, 2021 |
| <u>/s/ MICHELLE P. GOOLSBY</u> Michelle P. Goolsby | Director | February 16, 2021 |
| <u>/s/ GARY KEISER</u> Gary Keiser | Director | February 16, 2021 |
| <u>/s/ CHRISTOPHER W. MAHOWALD</u> Christopher W. Mahowald | Chairman and Director | February 16, 2021 |
| <u>/s/ MICHAEL G. O'NEIL</u> Michael G. O'Neil | Director | February 16, 2021 |
| <u>/s/ PHILLIP A. REINSCH</u> Phillip A. Reinsch | President, Chief Executive Officer and Director | February 18, 2021 |
| <u>/s/ MARK S. WHITING</u> Mark S. Whiting | Director | February 16, 2021 |

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the following Registration Statements:

- Form S-8 (No. 333-197302); and
- Form S-3/A (No. 333-251076)

of Capstead Mortgage Corporation of our reports dated February 19, 2021 with respect to the consolidated financial statements of Capstead Mortgage Corporation and the effectiveness of internal control over financial reporting of Capstead Mortgage Corporation included in this Annual Report (Form 10-K) of Capstead Mortgage Corporation for the year ended December 31, 2020.

/s/ ERNST & YOUNG LLP

Dallas, Texas
February 19, 2021

**CAPSTEAD MORTGAGE CORPORATION
CERTIFICATION PURSUANT TO SECTION 302(a)
OF THE SARBANES-OXLEY ACT OF 2002**

I, Phillip A. Reinsch, certify that:

1. I have reviewed this Annual Report on Form 10-K of Capstead Mortgage Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 19, 2021

By: /s/ PHILLIP A. REINSCH
Phillip A. Reinsch
President and Chief Executive Officer

**CAPSTEAD MORTGAGE CORPORATION
CERTIFICATION PURSUANT TO SECTION 302(a)
OF THE SARBANES-OXLEY ACT OF 2002**

I, Lance J. Phillips, certify that:

1. I have reviewed this Annual Report on Form 10-K of Capstead Mortgage Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 19, 2021

By: /s/ LANCE J. PHILLIPS

Lance J. Phillips
Senior Vice President, Chief
Financial Officer and Secretary

**CAPSTEAD MORTGAGE CORPORATION
CERTIFICATIONS PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of Capstead Mortgage Corporation (the “Company”) for the period ended December 31, 2020, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Phillip A. Reinsch, President and Chief Executive Officer of the Company, certify to my knowledge and in my capacity as an officer of the Company, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 19, 2021

By: /s/ PHILLIP A. REINSCH
Phillip A. Reinsch
President and Chief Executive Officer

**CAPSTEAD MORTGAGE CORPORATION
CERTIFICATIONS PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of Capstead Mortgage Corporation (the “Company”) for the period ended December 31, 2020, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Lance J. Phillips, Senior Vice President, Chief Financial Officer and Secretary of the Company, certify to my knowledge and in my capacity as an officer of the Company, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 19, 2021

By: /s/ LANCE J. PHILLIPS

Lance J. Phillips
Senior Vice President, Chief
Financial Officer and Secretary