

Western Asset Mortgage Capital Corp  
Form S-11/A  
September 27, 2012

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As filed with the Securities and Exchange Commission on September 27, 2012

Registration Statement No. 333-183840

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

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**Amendment No. 1  
to  
FORM S-11  
FOR REGISTRATION  
UNDER  
THE SECURITIES ACT OF 1933  
OF CERTAIN REAL ESTATE COMPANIES**

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**Western Asset Mortgage Capital Corporation**

(Exact name of registrant as specified in its governing instruments)

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**Western Asset Mortgage Capital Corporation  
385 East Colorado Boulevard  
Pasadena, California 91101  
(626) 844-9400**

(Address, including Zip Code, and Telephone Number, including Area Code, of Registrant's Principal Executive Offices)

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**Charles A. Ruys de Perez  
c/o Western Asset Management Company  
385 East Colorado Boulevard  
Pasadena, California 91101  
(626) 844-9400**

(Name, Address, including Zip Code, and Telephone Number, including Area Code, of Agent for Service)

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*Copies to:*

# Edgar Filing: Western Asset Mortgage Capital Corp - Form S-11/A

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**Approximate date of commencement of proposed sale to the public:**  
 As soon as practicable after the effective date of this registration statement.

If any of the Securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, check the following box:

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box.

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

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller Reporting Company   
 (Do not check if a smaller reporting company)

### CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities To Be Registered	Proposed Maximum Aggregate Offering Price <sup>(1)</sup>	Amount Of Registration Fee <sup>(1)(2)(3)</sup>
Common Stock, par value \$0.01	\$350,000,000	\$40,110

- (1) Estimated solely for the purpose of determining the registration fee in accordance with Rule 457(o) of the Securities Act of 1933, as amended.
- (2) Calculated in accordance with Rule 457(o) under the Securities Act of 1933, as amended.
- (3) The Registrant previously paid \$11,460 of this amount in connection with the initial filing of this Registration Statement.

**The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.**

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**The information in this preliminary prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is declared effective. This preliminary prospectus is not an offer to sell these securities and we are not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.**

**Subject to Completion, Preliminary Prospectus dated September 27, 2012**

**PROSPECTUS**

**12,000,000 Shares**

**Common Stock**

Western Asset Mortgage Capital Corporation is a Delaware corporation focused on investing in, financing and managing primarily Agency RMBS, which are residential mortgage-backed securities for which the principal and interest payments are guaranteed by a U.S. Government agency, such as the Government National Mortgage Association, or a U.S. Government-sponsored entity, such as the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation. Although our core investment strategy is focused on Agency RMBS, we may opportunistically supplement our portfolio with residential mortgage-backed securities that are not guaranteed by a U.S. Government agency or sponsored entity, commercial mortgage-backed securities and other asset-backed securities. We are externally managed and advised by Western Asset Management Company, or our Manager, an investment advisor registered with the Securities and Exchange Commission and a wholly-owned subsidiary of Legg Mason, Inc. (NYSE: LM). We are offering 12,000,000 shares of our common stock, par value \$0.01 per share, as described in this prospectus. Our common stock is listed on the New York Stock Exchange under the symbol "WMC." On September 26, 2012, the last reported price of our common stock was \$23.90 per share.

We intend to elect and qualify to be taxed as a real estate investment trust for U.S. federal income tax purposes, commencing with our taxable year ending December 31, 2012. To assist us in qualifying as a real estate investment trust, stockholders are generally restricted from owning more than 9.8% by value or number of shares, whichever is more restrictive, of our outstanding shares of common or capital stock. Our amended and restated certificate of incorporation contains various other restrictions on the ownership and transfer of our common stock. See "Description of capital stock Restrictions on ownership and transfer of our capital stock."

We are an "emerging growth company" as that term is used in the Jumpstart Our Business Startups Act of 2012, or the JOBS Act.

**Investing in our common stock involves risks. See "Risk factors" beginning on page 24 of this prospectus for a discussion of the following and other risks.**

	<b>Per Share</b>	<b>Total</b>
Public offering	\$	\$
Underwriting discount	\$	\$
Proceeds, before expenses, to us	\$	\$

The underwriters may also purchase up to an additional 1,800,000 shares of our common stock from us at the initial public offering price, less the underwriting discount, within 30 days after the date of this prospectus.

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

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The shares will be ready for delivery on or about \_\_\_\_\_, 2012.

**Deutsche Bank Securities**

**Citigroup**  
The date of this prospectus is

**J.P. Morgan**  
, 2012.

**Jefferies**

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You should rely only on the information contained in this prospectus or in any free writing prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different or additional information. If anyone provides you with different or additional information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus and any free writing prospectus prepared by us is accurate only as of their respective dates or on the date or dates which are specified in these documents. Our business, financial condition, liquidity, results of operations and prospects may have changed since those dates.

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**Summary**

*This summary highlights some of the information in this prospectus. It does not contain all of the information that you should consider before investing in our common stock. You should read carefully the more detailed information set forth under "Risk Factors" and the other information included in this prospectus. Except where the context suggests otherwise, the terms "company," "we," "us," and "our" refer to Western Asset Mortgage Capital Corporation, a Delaware corporation, and "our Manager" refers to Western Asset Management Company, a California corporation, our external manager. Unless indicated otherwise, the information in this prospectus assumes no exercise by the underwriters of their option to purchase up to an additional 1,800,000 shares of our common stock.*

**Our Company**

We are organized as a Delaware corporation focused on investing in, financing and managing primarily residential mortgage-backed securities, or RMBS, for which the principal and interest payments are guaranteed by a U.S. Government agency, such as the Government National Mortgage Association, or GNMA, or a U.S. Government-sponsored entity, including the Federal National Mortgage Association, or FNMA, and the Federal Home Loan Mortgage Corporation, or FHLMC. We refer to these types of securities as Agency RMBS. Although our core investment strategy is focused on Agency RMBS, we may opportunistically supplement our portfolio with RMBS that are not guaranteed by a U.S. Government agency or U.S. Government-sponsored entity, or non-Agency RMBS, commercial mortgage-backed securities, or CMBS, and other asset-backed securities, or ABS. We refer to these assets as our potential target assets. We finance our investments in Agency RMBS and intend to finance our potential target assets primarily through the use of repurchase agreements.

Our objective is to provide attractive risk-adjusted returns to our investors over the long term, primarily through dividends and secondarily through capital appreciation without sacrificing capital preservation. In pursuing this objective, we rely on our Manager's expertise to construct and manage a diversified mortgage investment portfolio by identifying asset classes that, when properly financed and hedged, are designed to produce attractive returns across a variety of market conditions and economic cycles, while considering the risks associated with owning such investments.

We are externally managed and advised by our Manager, an investment advisor registered with the U.S. Securities and Exchange Commission, or the SEC, and a wholly-owned subsidiary of Legg Mason, Inc., or Legg Mason (NYSE: LM). Our Manager is responsible for administering our business activities and day-to-day operations, subject to the supervision and oversight of our board of directors.

We were organized as a Delaware corporation on June 3, 2009. We commenced operations on May 15, 2012 following the completion of our initial public offering, or IPO, and the two concurrent private placements, as further described under "Our IPO and concurrent private placements".

We intend to elect and qualify to be taxed as a real estate investment trust, or REIT, for U.S. federal income tax purposes, commencing with our taxable year ending December 31, 2012. We generally will not be subject to U.S. federal income taxes on our taxable income to the extent that we annually distribute all of our net taxable income to stockholders and maintain our intended qualification as a REIT. We also operate our business in a manner that permits us to maintain our exemption from registration under the Investment Company Act of 1940, or the 1940 Act.

**Current market opportunities**

Since the height of the financial crisis in 2008, there have been a number of proposals put forward regarding the reform of the housing finance market. We believe the most important theme of these proposals, as highlighted in the U.S. Department of Treasury and Department of Housing and Urban Development report to Congress on February 11, 2011, is the reduction of the government's role in,

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and the return of private capital to, the housing finance market. Several tools intended to encourage investment of private capital were recommended in the U.S. Department of Treasury and Department of Housing and Urban Development report including increasing guarantee fees, decreasing loan limits and tightening underwriting criteria for conforming loans. We believe these recommended changes, some of which have begun to be implemented, such as the tightening of conforming loan limits in October 2011 and the announcement in August 2012 that FNMA and FHLMC would increase guarantee fees by the end of 2012, will reduce the future supply of Agency RMBS, limit mortgage refinancing and associated prepayment risk, and reduce the future volatility of the Agency RMBS market, which we view as positive developments for existing Agency RMBS.

We believe investors continue to seek incremental spreads relative to U.S. Treasury Notes in a low yield environment and financial institutions continue to prefer high quality, liquid Agency RMBS. In addition, our Manager has observed that the long-standing correlation between the prepayment rates of borrowers and their ability to refinance mortgage loans (as defined by the difference between available rates in the market and the legacy rates being paid by borrowers) has become partially de-linked in the past several years. Our Manager believes this is primarily a result of the inability of many borrowers to refinance their existing mortgages because of the significant decrease in the equity value of those borrowers' homes and more stringent underwriting standards. With yield spreads on Agency RMBS at what our Manager views as attractive levels, our Manager believes there will continue to be strong demand for Agency RMBS.

Although our core investment strategy is focused on Agency RMBS, we may opportunistically supplement our portfolio with non-Agency RMBS, which are collateralized by non-conforming residential mortgages. While we anticipate mortgage loan delinquencies and credit losses may continue to rise and housing conditions may continue to deteriorate, we believe that current prices for certain non-Agency RMBS offer the potential for attractive risk-adjusted returns. Over time, we believe reform of U.S. Government-sponsored entities will accelerate the demand for private capital into the housing finance sector, and we expect that we will be well positioned to make attractive risk-adjusted investments in new residential-mortgage assets.

The current interest rate environment is characterized by a steep yield curve with the spread between two-year U.S. Treasury Notes and 10-year U.S. Treasury Notes well above the average spread over the last three decades. The Federal Reserve Board has maintained a near-zero target for the federal funds rate. On August 1, 2012, the Federal Open Market Committee released a statement indicating that it would maintain the target range for the federal funds rate at 0% to 0.25% and that it continues to anticipate that economic conditions, including low rates of resource utilization and a subdued outlook for inflation over the medium term, are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014, reiterating previous statements by the Federal Open Market Committee from January and April 2012. Our Manager believes recent economic data suggest an improvement in U.S. economic growth. However, certain indicators such as high unemployment, low levels of capacity utilization, the current large shadow inventory of non-performing loans, declining or stagnant home prices in most markets and continued stress in the housing and construction markets all point to a muted recovery. We believe this slow growth environment should keep the yield curve relatively steep and promote continued demand for Agency and non-Agency RMBS.

As the capital markets have recovered, commercial banks have re-entered the secured lending market which has quickened the pace of the recovery of asset values in the credit markets. Financing of Agency and non-Agency RMBS is currently widely available through, among other vehicles, repurchase agreements. Haircuts, or the discount attributed to the value of securities sold under repurchase agreements, average between 3% and 10% for Agency RMBS and average between 10% and 50% for non-Agency RMBS, depending on the specific security used as collateral for such repurchase agreements. We use leverage to seek to increase potential returns to our stockholders by borrowing

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against existing assets through repurchase agreements and using the proceeds to acquire additional assets.

Our Manager's views of the current market opportunities are based on its own assessments. There can be no assurance that our investment and financing strategies based on our Manager's views will be able to generate attractive returns for our stockholders. For additional information regarding recent developments impacting the RMBS market, see "Recent developments".

**Our Manager**

We are externally managed and advised by Western Asset Management Company. Established in 1971 and acquired by Legg Mason in 1986, our Manager is a registered investment advisor headquartered in Pasadena, California, that specializes in fixed-income asset management. From offices in Pasadena, Dubai, Hong Kong, London, Melbourne, New York, São Paulo, Singapore and Tokyo, our Manager's 889 employees provide investment services for a wide variety of global clients, including mutual funds, corporate, public, insurance, health care, union organizations and charitable foundations. Client portfolios range across an equally wide variety of mandates, from money markets to emerging markets. As of June 30, 2012, our Manager had 516 clients, representing 40 countries and 1,057 accounts. By concentrating resources on fixed-income, our Manager is able to fully commit to serving clients of all types within the fixed-income sector.

As of June 30, 2012, our Manager and its investment advisory affiliates over which our Manager has operational responsibility, or its supervised affiliates, had approximately \$446 billion in assets under management. As of June 30, 2012, our Manager had approximately \$65.8 billion in assets under management in the asset classes corresponding to Agency RMBS and our potential target assets, of which approximately \$40.5 billion was invested in Agency RMBS, approximately \$13.2 billion in non-Agency RMBS, approximately \$2.6 billion in CMBS and approximately \$9.5 billion in ABS. Our Manager manages these assets using a range of specific strategies and investment vehicles, including mutual and private funds, private commingled vehicles and separately managed accounts. Our Manager's investment professionals and other staff have extensive experience in managing fixed-income assets, including Agency RMBS, non-Agency RMBS, CMBS, ABS and other such instruments.

Our chief investment officer, Stephen P. Fulton, who also serves as the head of our Manager's Agency RMBS team, is, along with two senior portfolio managers from the Agency RMBS team, primarily responsible for overseeing the management of our assets. The Agency RMBS team works alongside and is able to utilize the resources of our Manager's structured products team, which focuses on managing and evaluating our potential target assets, including non-Agency RMBS, CMBS and ABS. The Agency RMBS team is also able to call on the experience of a number of our Manager's other investment professionals, not specifically dedicated to managing our assets, but with expertise that covers certain aspects of our potential target assets as well as on specialists in derivatives and liquidity who are part of our Manager's broader investment team. The collective team operates under the purview of our Manager's U.S. broad markets committee which sets overall sector allocations for broad market accounts. Our Manager seeks to unite groups of specialists dedicated to different market sectors. The daily interaction among the different teams is designed to develop a consensus approach that draws on the expertise of all team members. Our Manager's overall investment management team consists of 124 investment professionals.

**Our investment strategy**

Our Manager's investment philosophy, which developed from a singular focus in fixed-income asset management over a variety of credit cycles and conditions, is to provide clients with diversified, tightly controlled, long-term value-oriented portfolios. Through rigorous analysis of all sectors of the fixed-income market, our Manager seeks to identify assets with the greatest risk-adjusted total value

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potential. In making investment decisions on our behalf, our Manager incorporates its views on the economic environment and the outlook for the mortgage markets, including relative valuation, supply and demand trends, the level of interest rates, the shape of the yield curve, prepayment rates, financing and liquidity, commercial and residential real estate prices, delinquencies, default rates, recovery of various segments of the economy and vintage of collateral, subject to maintaining our REIT qualification and our exemption from registration under the 1940 Act. We benefit from the breadth and depth of our Manager's overall investment philosophy, which focuses on a macroeconomic analysis as well as an in-depth analysis of individual assets and their relative value.

We rely on our Manager's expertise in asset allocation and identifying attractive assets within our investment strategy. Although our core investment strategy is focused on Agency RMBS, our Manager's expertise in related investment disciplines such as non-Agency RMBS, CMBS and ABS provides our Manager with both (1) valuable investment insights to our RMBS investment selection and strategy and (2) flexibility to invest in assets other than Agency RMBS opportunistically as market conditions warrant.

We purchase and sell Agency RMBS and may, in the future, purchase and sell our potential target assets. Our Manager does not purchase securities on our behalf with a view to selling them shortly after purchase. However, in order to maximize returns and manage portfolio risk while remaining opportunistic, we may dispose of securities earlier than anticipated or hold securities longer than anticipated depending upon prevailing market conditions, credit performance, availability of leverage or other factors regarding a particular security or our capital position.

**Agency RMBS**

Agency RMBS, which are RMBS for which the principal and interest payments are guaranteed by a U.S. Government agency, such as the GNMA, or a U.S. Government-sponsored entity, such as the FNMA or the FHLMC. The Agency RMBS we acquire could be secured by fixed-rate mortgages, adjustable-rate mortgages or hybrid adjustable-rate mortgages. Fixed-rate mortgages have interest rates that are fixed for the term of the loan and do not adjust. The interest rates on adjustable-rate mortgages generally adjust annually (although some may adjust more frequently) to an increment over a specified interest rate index. Hybrid adjustable-rate mortgages have interest rates that are fixed for a specified period of time (typically three, five, seven or ten years) and, thereafter, adjust to an increment over a specified interest rate index. Adjustable-rate mortgages and hybrid adjustable-rate mortgages generally have periodic and lifetime constraints on how much the loan interest rate can change on any predetermined interest rate reset date. As of June 30, 2012, all of our Agency RMBS were secured by fixed-rate mortgages.

We have invested the proceeds of our IPO and concurrent private placements and expect to continue to focus on investing in the following types of securities:

*Mortgage pass-through certificates.* Mortgage pass-through certificates are securities representing interests in "pools" of mortgage loans secured by residential real property where payments of both interest and principal, plus pre-paid principal, on the securities are made monthly to holders of the securities, in effect "passing through" monthly payments made by the individual borrowers on the mortgage loans that underlie the securities, net of fees paid to the issuer/guarantor and servicers of the securities.

*Agency Derivatives*

We refer to Agency Interest-Only Strips and Agency Inverse Interest-Only Strips as Agency Derivatives. Both of these are Agency RMBS that represent a type of Collateralized Mortgage Obligation.

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*Agency Interest-Only Strips.* This type of security only entitles the holder to interest payments. The yield to maturity of Agency Interest-Only Strips is extremely sensitive to the rate of principal payments (particularly prepayments) on the underlying pool of mortgages. We invest in these types of securities primarily to take advantage of particularly attractive prepayment-related or structural opportunities in the Agency RMBS markets, as well as to help manage the duration of our overall portfolio.

*Agency Inverse Interest-Only RMBS.* This type of security has a coupon with an inverse relationship to its index and is subject to caps and floors. Agency Inverse Interest-Only RMBS entitles the holder to interest only payments based on a notional principal balance, which is typically equal to a fixed rate of interest on the notional principal balance less a floating rate of interest on the notional principal balance that adjusts according to an index subject to set minimum and maximum rates. The value of Agency Inverse Interest-Only RMBS will generally decrease when its related index rate increases and increase when its related index rate decreases.

*Collateralized Mortgage Obligations, or CMOs.* CMOs are securities that are structured from residential pass-through certificates, which receive monthly payments of principal and interest. CMOs divide the cash flows which come from the underlying mortgage pass-through certificates into different classes of securities that may have different maturities and different weighted average lives than the underlying pass-through certificates.

Other Agency RMBS we intend to invest in, but have not yet done so, are described below.

*TBAs.* We may utilize "to-be-announced" forward contracts, or TBAs, in order to invest in Agency RMBS. Pursuant to these TBAs, we would agree to purchase, for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered would not be identified until shortly before the TBA settlement date. Our ability to purchase Agency RMBS through TBAs may be limited by the 75% income and asset tests applicable to REITs. See "U.S. federal income tax considerations Taxation of Western Asset Mortgage Capital Corporation."

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The following table presents certain information about our investment portfolio at June 30, 2012:

	Principal Balance <sup>(1)</sup>	Unamortized Premium (Discount)	Amortized Cost <sup>(1)</sup>	Unrealized Gain (Loss)	Estimated Fair Value <sup>(1)</sup>	Net Weighted Average Coupon <sup>(2)</sup>	Weighted Average Yield <sup>(3)</sup>
<b>30-Year Mortgage</b>							
Coupon Rate:							
3.00%	\$ 159,816	\$ 3,034	\$ 162,850	\$ 1,189	\$ 164,039	3.0%	2.8%
3.50%	784,902	40,643	825,545	2,639	828,184	3.5%	3.0%
4.00%	419,065	31,108	450,173	(77)	450,096	4.0%	3.0%
7.00%	77,035	12,449	89,484	179	89,663	7.0%	0.9%
	1,440,818	87,234	1,528,052	3,930	1,531,982	3.8%	2.8%
<b>20-Year Mortgage</b>							
Coupon Rate:							
3.50%	186,074	11,062	197,136	(252)	196,884	3.5%	2.4%
4.00%	24,916	2,008	26,924	(88)	26,836	4.0%	2.3%
	210,990	13,070	224,060	(340)	223,720	3.6%	2.4%
CMO Fixed Rate IOs and IIOs <sup>(4)</sup>	66,000	11,124	77,124	(316)	76,808	6.5%	4.9%
Agency interest-only strips accounted for as derivatives <sup>(4)</sup>					26,844	4.2% <sup>(5)</sup>	1.6%
					86,322	4.3%	6.4%
<b>Total</b>			\$ 1,888,063	\$ 3,925	\$ 1,918,832	4.0%	3.0%

- (1) Includes unsettled purchases with an aggregate cost of \$105,912 and estimated fair value of \$106,019 at June 30, 2012.
- (2) Net weighted average coupon as of June 30, 2012 is presented net of servicing and other fees.
- (3) Weighted average yield as of June 30, 2012 incorporates estimates for future prepayment and loss assumptions.
- (4) IOs and IIOs and Agency Interest-Only Strips accounted for as derivatives have no principal balances and bear interest based on a notional balance. The notional balance is used solely to determine interest distributions on interest-only class of securities.
- (5) Interest on these securities is reported as a component of Loss on derivative instruments.

Since June 30, 2012, we have made certain acquisitions and dispositions of Agency RMBS that have resulted in adjustments to our investment portfolio's allocation of the subcategories of Agency RMBS described above; however, these adjustments have not been material.

### Potential target assets

Although our core investment strategy is focused on Agency RMBS, we may opportunistically supplement our portfolio with the types of assets described below.

*Non-Agency RMBS.* RMBS that are not guaranteed by a U.S. Government agency or U.S. Government-sponsored entity, with an emphasis on securities that when originally issued were rated in the highest rating category by one or more of the nationally recognized statistical rating organizations.

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The mortgage loan collateral for non-Agency RMBS consists of residential mortgage loans that do not generally conform to underwriting guidelines issued by a U.S. Government agency or U.S. Government-sponsored entity due to certain factors, including mortgage balances in excess of agency underwriting guidelines, borrower characteristics, loan characteristics and level of documentation, and therefore are not issued or guaranteed by an agency. The mortgage loan collateral may be classified as subprime, Alternative-A or prime depending on the borrower's credit rating. The non-Agency RMBS

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we may acquire could be secured by fixed-rate mortgages, adjustable-rate mortgages or hybrid adjustable-rate mortgages.

**CMBS.** Fixed and floating rate CMBS, with an emphasis on securities that when originally issued were rated in the highest rating category by one or more of the nationally recognized statistical rating organizations. We have not established a minimum current rating requirement.

**ABS.** Debt and equity tranches of securitizations backed by various asset classes including, but not limited to, small balance commercial mortgages, aircrafts, automobiles, credit cards, equipment, manufactured housing, franchises, recreational vehicles and student loans with an emphasis on securities that when originally issued were rated in the highest rating category by one or more of the nationally recognized statistical rating organizations. Investments in ABS generally are not qualifying assets for purposes of the 75% asset test applicable to REITs and generally do not generate qualifying income for purposes of the 75% income test applicable to REITs. As a result, we may be limited in our ability to invest in such assets. See "U.S. federal income tax considerations Taxation of Western Asset Mortgage Capital Corporation.

**Other Agency MBS.** We may also invest in mortgage-backed securities, or MBS, for which the principal and interest payments are guaranteed by a U.S. Government-sponsored entity, but for which the underlying mortgage loans are secured by real property other than single family residences. These may include, but are not limited to the FNMA's DUS (Delegated Underwriting and Servicing) MBS, the FHLMC's Multifamily Mortgage Participation Certificates and the GNMA's project loan pools, or CMOs structured from such collateral.

### **Our competitive advantages**

We believe that our competitive advantages include the following:

#### ***Significant experience of our Manager***

Our Manager has utilized Agency RMBS as a vital component within its investment strategy since its inception in 1971 and has managed through several interest rate, housing, and credit cycles. Our Manager has extensive experience managing Agency RMBS strategies as separately-managed accounts, commingled vehicles, and mutual funds. These strategies include Agency RMBS only, the GNMA's RMBS only and several Agency RMBS strategies with varying degrees of non-Agency RMBS exposure. Agency RMBS has also been a significant portion of our Manager's broad market strategies since 1971. Moreover, our Manager has been an active investor in non-Agency RMBS, CMBS and ABS for over 20 years as those markets have developed. Our Manager manages these assets in broad market accounts as well as non-Agency RMBS specific strategies, including commingled funds and mutual funds. We have access to our Manager's dedicated Agency RMBS team, which is led by our chief investment officer. In addition, we utilize the resources of our Manager's structured products team, which focuses on our potential target assets, including non-Agency RMBS, CMBS and ABS. We also call on the experience of specialists in derivatives and liquidity who are part of our Manager's broader investment team. In addition, we believe that our Manager's senior management team, which has a long track record and broad experience in managing mortgage-related assets through a variety of credit and interest rate environments, has demonstrated the ability to generate attractive risk-adjusted returns under different market conditions and cycles and provides us with a competitive advantage.

#### ***Extensive strategic relationships***

Our Manager and its supervised affiliates maintain extensive long-term relationships with other financial intermediaries, including primary dealers, leading investment banks, brokerage firms, leading mortgage originators and commercial banks. As one of the largest fixed-income investment managers in

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the world, our Manager has access to deal flow and secondary trading opportunities to which smaller firms do not have access. Additionally, our Manager's size and broad market access are valuable in developing and implementing our investment strategy. We believe these relationships enhance our ability to source, finance and hedge investment opportunities and, thus, will enable us to grow in various credit and interest rate environments. In addition, we believe the contacts our Manager and its supervised affiliates have with numerous investment grade derivative and lending counterparties assist us in implementing our financing and hedging strategies.

***Disciplined investment approach***

Our Manager takes a value-oriented approach to managing Agency RMBS. Using that approach, our Manager seeks to optimize yield while adjusting for prepayment and interest rate risk.

From a macroeconomic perspective, our Manager examines current and forward interest rates, the shape of the yield curve, gross domestic product, or GDP, growth and inflation expectations, regional and local property trends, local employment conditions, national loan modification initiatives and mortgage servicer timelines and techniques. At the security level, our Manager examines borrower and collateral characteristics such as the incentives a homeowner might have to refinance and the level of equity in the home.

***Access to our Manager's analytical tools and infrastructure***

Our Manager uses its analytical and portfolio management modeling tools and processes to seek to generate positive net interest margins for our assets. We employ a combination of proprietary and third-party tools in an effort to identify investments in the Agency RMBS sector with the most attractive risk-adjusted returns.

Our Manager analyzes macroeconomic factors to seek to determine the appropriate sector mix and strategy for us that best capitalizes on the market knowledge, experience and relationships within our Manager's existing platform. We capitalize on the market knowledge and ready access to data across our target markets that our Manager obtains through these tools and processes and believe that our Manager's sophisticated analysis of both macro and micro economic factors positions us to manage cash flows from Agency RMBS and our potential target assets and make distributions to our stockholders while preserving capital. We believe we also benefit from our Manager's comprehensive finance and administrative infrastructure, including its risk management and financial reporting operations, as well as its business development, legal and compliance teams.

***Alignment of our Manager's interests***

We have taken steps to structure our relationship with our Manager so that our interests and those of our Manager are closely aligned. Concurrently with the closing of our IPO, we issued and sold in a private placement 46,043 shares of our common stock at \$20.00 per share to our Manager's deferred compensation plan, which made such investment on behalf of the beneficiaries of the plan, which includes certain executives and other employees of our Manager and its affiliates. These shares are subject to a two year lock-up agreement from the date of our IPO with the underwriters of that offering.

In addition, our equity incentive plans allow us to grant common stock-based awards to our Manager and its employees, including our executive officers, representing up to 3.0% of the total number of issued and outstanding shares of our common stock (on a fully diluted basis) at the time of each award (other than any shares issued or subject to awards made pursuant to one of our equity incentive plans). Upon the consummation of our IPO, we granted 51,159 shares of our restricted common stock to our Manager under one of our equity incentive plans. One-third of these shares vest on each of the first, second and third anniversaries of the grant date.

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**Investment guidelines**

Our board of directors has adopted a set of investment guidelines that sets forth our target asset classes and other criteria to be used by our Manager to evaluate specific assets as well as our overall portfolio composition. Our Manager makes determinations as to the percentage of our assets that will be invested in each of our target asset classes, consistent with the investment guidelines adopted by our board of directors and the limits necessary to maintain compliance with REIT tax rules and our exemption under the 1940 Act. Our Manager's investment decisions depend on prevailing market conditions and may change over time in response to opportunities available in different interest rate, economic and credit environments. As a result, we cannot predict the percentage of our assets that will be invested in any of our target asset classes at any given time, although we are focused on investing in Agency RMBS, and to date have invested almost exclusively in Agency RMBS. We believe that the diversification of our portfolio of assets, our Manager's extensive experience in investing in Agency RMBS and our potential target assets and the flexibility of our strategy, combined with our Manager's and its supervised affiliates' general investment and advisory expertise and comprehensive finance and administrative infrastructure, will enable us to achieve attractive risk-adjusted returns under a variety of market conditions and economic cycles.

Our investment guidelines may be changed from time to time by our board of directors without the approval of our stockholders. Changes to our investment guidelines may include, without limitation, modification or expansion of the types of assets in which we may invest.

**Our financing strategy and leverage**

We fund the acquisition of our assets through the use of leverage from a number of financing sources, subject to maintaining our qualification as a REIT. We finance purchases of Agency RMBS and intend to finance future purchases of our potential target assets primarily through the use of repurchase agreements.

We use leverage to increase potential returns to our stockholders. We accomplish this by borrowing against existing assets through repurchase agreements and using the proceeds to acquire additional assets. There are no limits on the maximum amount of leverage that we may use, and we are not required to maintain any particular debt-to-equity leverage ratio. We may also change our financing strategy and leverage without the consent of our stockholders.

We currently borrow between seven to eleven times the amount of our stockholders' equity (calculated in accordance with accounting principles generally accepted in the United States, or U.S. GAAP), although there is no minimum or maximum leverage that our investment policies explicitly require. Depending on the different cost of borrowing funds at different maturities, we vary the maturities of our borrowed funds to attempt to produce lower borrowing costs and reduce interest rate risk. We have entered into repurchase agreements only with institutions that are rated investment grade by at least one nationally-recognized statistical rating organization. As of June 30, 2012, we had entered into repurchase agreements with nine counterparties and had borrowings of approximately \$1.7 billion as of that date with those counterparties.

The leverage that we employ is specific to each asset class and is determined based on several factors, including potential asset price volatility, margin requirements, the current cycle for interest rates, the shape of the yield curve, the outlook for interest rates and our ability to use and the effectiveness of interest rate hedges. We analyze both historical volatility and market-driven implied volatility for each asset class in order to determine potential asset price volatility. Our leverage targets attempt to risk-adjust asset classes based on each asset class's potential price volatility. The goal of our leverage strategy is to ensure that, at all times, our investment portfolio's overall leverage ratio is appropriate for the level of risk inherent in the investment portfolio, and that each asset class has individual leverage targets that are appropriate for its potential price volatility.