

CAPSTEAD MORTGAGE CORP

Form 10-K

March 01, 2011

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-K**

ii ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended: December 31, 2010

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)

**75-2027937**  
(I.R.S. Employer Identification No.)

**8401 North Central Expressway, Suite 800, Dallas, TX**  
(Address of principal executive offices)

**75225**  
(Zip Code)

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

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

<b>Title of Each Class</b>	<b>Name of Exchange on Which Registered</b>
Common Stock (\$0.01 par value)	New York Stock Exchange
\$1.60 Cumulative Preferred Stock, Series A (\$0.10 par value)	New York Stock Exchange
\$1.26 Cumulative Convertible Preferred Stock, Series B (\$0.10 par value)	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

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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, 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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that Registrant was required to submit and post such files).

YES  NO

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

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

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

**At June 30, 2010 the aggregate market value of the common stock held by nonaffiliates was \$765,245,072.**

**Number of shares of Common Stock outstanding at February 28, 2011 71,721,950**

**DOCUMENTS INCORPORATED BY REFERENCE:**

**Portions of the Registrant's definitive Proxy Statement, to be issued in connection with the 2011 Annual Meeting of Stockholders of the Registrant, are incorporated by reference into Part III.**

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**CAPSTEAD MORTGAGE CORPORATION**

**2010 FORM 10-K ANNUAL REPORT**

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**PART I**

**ITEM 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 consisting almost exclusively of adjustable-rate mortgage ( ARM ) securities issued and guaranteed by government-sponsored enterprises, either Fannie Mae or Freddie Mac (together, the GSEs ), or by an agency of the federal government, Ginnie Mae. Agency-guaranteed residential mortgage pass-through securities ( Agency Securities ) carry an implied AAA rating with limited, if any, credit risk, particularly in light of the conservatorship of the GSEs by the federal government.

Capstead's investment strategy is to manage a conservatively leveraged portfolio of ARM Agency Securities that can produce attractive risk-adjusted returns over the long term, while reducing, but not eliminating, sensitivity to changes in interest rates. This strategy differentiates the Company from its peers because ARM Agency Securities reset to more current interest rates within a relatively short period of time allowing for the recovery of financing spreads diminished during periods of rising interest rates and smaller fluctuations in portfolio values from changes in interest rates compared to portfolios that contain a significant amount of fixed-rate Agency Securities. From a credit-risk perspective, the credit quality of Agency Securities helps ensure that fluctuations in value due to credit risk should be limited and financing at reasonable rates and terms should remain available under stressed market conditions.

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 on investing in short-duration Agency Securities, Capstead competes for the acquisition of suitable investments with other mortgage REITs, commercial banks, savings banks, insurance companies, and institutional investors such as private equity funds, mutual funds, pension funds and sovereign wealth funds. In addition, the federal government, through the GSEs, the Federal Home Loan Banks and the Federal Reserve, has substantial holdings of primarily fixed-rate Agency Securities. Many of these entities have 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. Although higher pricing levels generally correspond to a higher book value per common share for the Company, higher pricing levels also generally result in lower portfolio yields, which could adversely affect future profitability.

Further, the policy goals of the federal government may differ from the economic goals of other investors in Agency Securities. For instance, the Federal Reserve or the GSEs may determine it is appropriate to reduce their holdings of Agency Securities, which could result in lower pricing levels. Although this may result in an opportunity to acquire assets at more attractive yields, the Company's book value per common share could be negatively affected.

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### **Regulation and Related Matters**

Operating as a REIT that primarily invests in Agency Securities subjects the Company to various federal regulatory requirements. For further discussion, see Item 7 of this report, Management's Discussion and Analysis of Financial Condition and Results of Operations, on pages 22 through 25 under the captions Risk Factors Related to Capstead's Status as a REIT and Other Tax Matters and Risk Factors Related to Capstead's Corporate Structure, which is incorporated herein by reference.

### **Employees**

As of December 31, 2010, the Company had 13 full-time employees and three part-time employees.

### **Website Access to Company Reports and Other Company Information**

Capstead makes available on its website at [www.capstead.com](http://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 amendments to such documents as soon as reasonably practicable after such materials are electronically filed or furnished to the SEC or otherwise publicly released.

Investors may also read and copy any materials filed with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site ([www.sec.gov](http://www.sec.gov)) through which investors may view reports, proxy and information statements, and other information filed with the SEC.

The Company also makes available on its website charters for the committees of its board of directors, its Board of Directors Guidelines, 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 75225-4410.

### **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, project, will be, will likely continue, will words or phrases of similar meaning. These 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:

changes in general economic conditions;

fluctuations in interest rates and levels of mortgage prepayments;

the effectiveness of risk management strategies;

the impact of differing levels of leverage employed;

liquidity of secondary markets and credit markets;

the availability of financing at reasonable levels and terms to support investing on a leveraged basis;

the availability of new investment capital;

increases in costs and other general competitive factors;

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deterioration in credit quality and ratings of existing or future issuances of Agency Securities;

the availability of suitable qualifying investments from both an investment return and regulatory perspective; and

changes in legislation or regulation affecting the GSEs and similar federal government agencies and related guarantees.

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 these forward-looking statements. 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. Any 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 the forward-looking statements.

**ITEM 1A. RISK FACTORS.**

Under the captions *Risk Factors* and *Critical Accounting Policies* on pages 18 through 25 and 25 through 27, respectively, of Item 7 *Management's Discussion and Analysis of Financial Condition and Results of Operations*, which is incorporated herein by reference, are discussions of risk factors and critical accounting policies affecting Capstead's financial condition and results of operations that are an integral part of this report. Readers are strongly urged to consider the potential impact of these factors and accounting policies on the Company while reading this document.

**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.

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The New York Stock Exchange trading symbol for Capstead's common shares is CMO. As of December 31, 2010, the Company had 1,396 common stockholders of record and depository companies held common shares for 36,450 beneficial owners. The high and low sales prices and dividends declared on the common shares were as follows:

	<i>Year Ended December 31, 2010</i>			<i>Year Ended December 31, 2009</i>		
	<i>Sales Prices</i>		<i>Dividends</i>	<i>Sales Prices</i>		<i>Dividends</i>
	<i>High</i>	<i>Low</i>	<i>Declared</i>	<i>High</i>	<i>Low</i>	<i>Declared</i>
First quarter	\$ 13.83	\$ 11.64	\$ 0.50	\$ 12.12	\$ 9.08	\$ 0.56
Second quarter	12.00	8.12	0.36	13.35	10.50	0.58
Third quarter	12.56	10.69	0.26	15.75	11.52	0.56
Fourth quarter	13.07	10.80	0.39	14.67	12.56	0.54

Set forth below is a graph comparing the yearly percentage change in the cumulative total stockholder return on Capstead common shares, with the cumulative total return of the Russell 2000 Index and the NAREIT Mortgage Index for the five years ended December 31, 2010 assuming the investment of \$100 on December 31, 2005 and the reinvestment of dividends. The stock price performance shown on the graph is not necessarily indicative of future price performance.

	<i>Period Ending</i>					
	<i>12/31/05</i>	<i>12/31/06</i>	<i>12/31/07</i>	<i>12/31/08</i>	<i>12/31/09</i>	<i>12/31/10</i>
Capstead Mortgage Corporation	\$ 100.00	\$ 144.35	\$ 235.95	\$ 229.63	\$ 344.99	\$ 360.91
Russell 2000 Index	100.00	118.37	116.51	77.15	98.11	124.46
NAREIT Mortgage Index	100.00	119.32	68.79	47.25	58.89	72.20



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See ITEM 11 of this report for information regarding equity compensation plans which is incorporated herein by reference. Capstead did not sell any unregistered securities during the past three fiscal years.

**ITEM 6. SELECTED FINANCIAL DATA.**

This table summarizes selected financial information. For additional information, refer to the audited financial statements and notes thereto included under Item 8 and Management's Discussion and Analysis of Financial Condition and Results of Operations, included under Item 7 of this report.

	<i>As of or for the year ended December 31</i>				
	<i>2010</i>	<i>2009</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>
<b>Selected statement of income data:</b>					
Interest income:					
Mortgage securities and similar investments	\$ 199,300	\$ 314,100	\$ 398,285	\$ 310,698	\$ 242,859
Other	478	495	2,204	945	413
	199,778	314,595	400,489	311,643	243,272
Interest expense:					
Repurchase arrangements and similar borrowings	(47,502)	(120,083)	(249,706)	(266,901)	(228,379)
Unsecured borrowings	(8,747)	(8,747)	(8,747)	(8,747)	(7,142)
Other	(2)				
	(56,251)	(128,830)	(258,453)	(275,648)	(235,521)
	143,527	185,765	142,036	35,995	7,751
Impairment and related charges associated with investments in commercial real estate loans <sup>(a)</sup>		(40,423)			
Loss from portfolio restructurings <sup>(b)</sup>			(1,484)	(7,683)	
Other revenue (expense)	(16,631)	(16,079)	(14,629)	(3,599)	(3,908)
<b>Net income</b>	<b>\$ 126,896</b>	<b>\$ 129,263</b>	<b>\$ 125,923</b>	<b>\$ 24,713</b>	<b>\$ 3,843</b>
Net income available (loss attributable) to common stockholders, after payment of preferred share dividends	\$ 106,663	\$ 109,024	\$ 105,672	\$ 4,457	\$ (16,413)
Basic earnings (loss) per common share	\$ 1.53	\$ 1.67	\$ 1.94	\$ 0.19	\$ (0.86)
Diluted earnings (loss) per common share	1.52	1.66	1.93	0.19	(0.86)
Cash dividends per common share	1.51	2.24	2.02	0.34	0.08
Average number of common shares outstanding: <sup>(d)</sup>					
Basic	69,552	65,045	54,007	22,947	18,902