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TWO - Q3 2015 Two Harbors Investment Corp Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to your Two Harbors Investment Corporation's third-quarter 2015 financial results conference call. (Operator Instructions).As a reminder, this conference call may be recorded. I'd like to hand the conference over to Ms. July Hugen, Director of Investor Relations. Ma'am, you may begin.

July Hugen - *Two Harbors Investment Corp. - Director, IR*

Thank you, Saeed and good morning. Welcome to our third-quarter 2015 financial results conference call. With me this morning are Tom Siering, President and Chief Executive Officer; Brad Farrell, Chief Financial Officer; and Bill Roth, Chief Investment Officer.

After my introductory comments, Tom will provide a recap of our third-quarter 2015 results. Brad will highlight some key items from our financials and Bill will review our portfolio performance and operational businesses.

The press release and financial tables associated with today's conference call were filed yesterday with the SEC. If you do not have a copy, you may find them on our website and the SEC's website. This call is being broadcast live over the Internet and may be accessed on our website in the Investor Relations section under the Events and Presentations link. We encourage you to reference the accompanying presentation to this call, which can be found on our website in the same location. Reconciliation of non-GAAP financial measures to GAAP can also be found in the appendix of the accompanying presentation.

We wish to remind you that remarks made by management during this conference call and the supporting slide presentation may include forward-looking statements. Forward-looking statements reflect our views regarding future events and are typically associated with the use of words such as anticipate, target, expect, estimate, believe, assume, project and should or other similar words.

We caution investors not to rely unduly on forward-looking statements. They imply risks and uncertainties and actual results may differ materially from expectations. We urge you to carefully consider the risks described in our filings with the SEC, which may be obtained on the SEC's website at www.SEC.gov. We do not undertake any obligation to update or correct forward-looking statements if later events prove them to be inaccurate. I will now turn the call over to Tom.



Tom Siering - Two Harbors Investment Corp. – President & CEO

Thank you, July. Good morning, everyone and thank you for joining our third-quarter 2015 earnings call. Please turn to slide 3 for an overview of our financial results and current market considerations. Our book value at September 30 was \$10.30 per share. In the third quarter, we realized a comprehensive loss of \$92.8 million or negative \$0.25 per weighted average share.

Core earnings were \$0.22 per weighted average share while we incurred a GAAP loss of \$0.09 per weighted average share. In the third quarter, we repurchased 1.4 million shares of the Company's common stock at an average purchase price of \$8.96 per share for an aggregate cost of approximately \$12.5 million.

As we have mentioned in the past, management remains committed to repurchasing shares when it makes sense economically for our stockholders. The Fed's decision not to raise interest rates led to volatility in the market. It remains possible that the Fed raises rates in late 2015 or early 2016 and currently the market suggests that there is roughly a 60% probability of a December rate hike.

Unemployment at 5.1% in September remains relatively low, but it is clear from the Fed statements that all benchmarks are becoming less of a determinant as they evaluate rate decisions. The job and housing markets have been stable and we anticipate them remaining so for the foreseeable future. Home price appreciation was up 6.4% on a rolling 12-month basis according to CoreLogic and they expect pricing gains of approximately 4.7% over the next 12 months.

That being said, given the recent volatility in the markets, we believe it is prudent to remain conservatively positioned with respect to interest rate exposure and continue to focus on transitioning capital to our new business initiatives, which is a perfect segue to slide 4.

In the third quarter, we sponsored two prime jumbo securitizations bringing our total securitization count through the first nine months of 2015 to 6 with a 7th deal sponsored subsequent to quarter-end. I would like to complement and thank the entire team at Two Harbors for their efforts in reaching our goal of 6 to 10 securitizations through 2015.

Most importantly, we are retaining the credit pieces from each of these deals to replace our legacy non-agency securities as that portfolio naturally pays down over time. We have been retaining some higher pieces of the capital when the math is compelling. Concurrent with our earnings release this quarter, we've launched the 8th webinar in our ongoing series titled Mortgage Loan Conduit and Securitization. This introductory webinar explains the securitization structure and process. We hope that you find it instructive.

With respect to MSR, we closed on two bulk acquisitions in the third quarter totaling approximately \$6.1 billion UPB and added 3 flow sellers. We are very pleased with the progress we have made on investments in commercial real estate debt in the quarter and year to date. The majority of the infrastructure was built in the first half of 2015 and we began putting capital to work in a more meaningful way in the third quarter of 2015.

We closed 8 loans in the third quarter with a carrying value of approximately \$245 million, which exceeded our expectations. Please turn to slide 5. We strive to be an industry leader bringing innovative capital solutions to the US real estate market. Our operating businesses are based on this mission and we are quite proud of the efforts made with respect to shifting capital to these franchises over the past several quarters.

Looking forward, we expect to expand our originator partner network and product offerings while remaining a regular issuer in the securitization marketplace and an active MSR participant through bulk transactions and flow arrangements. Moreover, we expect to grow our commercial real estate initiative by deploying the remainder of our initial \$500 million of equity investment in the fourth quarter of 2015 and into 2016. The evolution of these businesses should drive franchise value and stockholder returns.

I will now turn the call to Brad for a review of our financial results.

Brad Farrell - Two Harbors Investment Corp. - CFO & Treasurer

Thank you, Tom and good morning, everyone. Please turn to slide 6. Book value was \$10.30 per share at September 30 versus \$10.81 as of June 30. Our comprehensive loss of \$92.8 million in the third quarter was primarily driven by unrealized losses on our non-agency securities, swap and swaption positions and MSR portfolio. The Company also declared dividends of \$95.5 million or \$0.26 per share in the third quarter.



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Please turn to slide 7. Core earnings was \$0.22 per weighted share representing an annualized return on average equity of 8.1%. Core earnings was generally in line with our expectations. On the left-hand side, we have provided a detailed quarter-over-quarter analysis of core earnings and would like to discuss a couple of the key variances.

Interest income was generally flat quarter-over-quarter, but there are a few items to highlight. Interest income from our trading securities or US treasuries decreased \$4 million quarter-over-quarter due to the sale of a treasury bond in Q2. Furthermore, interest income on our available-for-sale securities decreased as the amortized cost of our holdings decreased from \$12.2 billion to \$10.9 billion due primarily to the sale of agency securities.

These items were mostly offset by slightly lower prepayments on certain of our IO securities, which resulted in an increase in yield, as well as an increase in our holdings of prime jumbo and commercial real estate mortgage loans. Our swap cost decreased 25.8% during the third quarter for a number of reasons, including a lower average notional balance was carried during the quarter due to the agency securities sales, a treasury hedge was unwound during the second quarter in conjunction with the previously mentioned sale of a treasury bond and a few swaps were reset at lower rates resulting in lower interest spread expense. Finally, servicing income decreased 37.2% due to a change in our core earnings MSR amortization methodology that took effect July 1, 2015. I would note that future MSR amortization will be heavily influenced by prepayment trends.

Please turn to slide 8 for an overview of our financing profile. I would like to highlight a couple of things on this page. The repo market for RMBS continues to ebb and flow with regard to liquidity and borrowing rates as the Basel III regulatory capital reform rules impact the lending appetite of financing providers. That being said, we did not experience any repo funding restrictions during the quarter.

The dynamic nature of the FHLB facility makes it a valuable financing tool that, among other things, allows us to seamlessly work through the natural shifts of the repo market, along with providing a stable and consistent funding source for our conduit business. Our FHLB advances totaled \$3.7 billion at quarter-end. With that, I will turn the call over to Bill.

Bill Roth - Two Harbors Investment Corp. - CIO

Thanks, Brad and good morning, everyone. Please turn to slide 9 as we review our portfolio performance and yields. Our annualized net interest spread was 2.83%, up 4 basis points from June 30. Net interest spread was positively impacted by generally stable yields across the portfolio, coupled with a decrease in the cost of our swaps and a lower average notional balance throughout the quarter.

From a book value perspective, both agency and credit spreads widened while swaps tightened versus US treasuries. These variables negatively impacted book value and made hedging a mortgage portfolio challenging during the quarter. Finally, given uncertainty around potential Fed actions, we believe it is prudent to continue to maintain low overall interest rate exposure.

Please turn to slide 10 to discuss the composition and allocation of capital across the business. As of September 30, the portfolio was \$14.1 billion in assets with roughly 53% of capital allocated to the rate strategy, 43% to the credit strategy and 4% to commercial real estate.

We reduced the capital allocation to agencies in the third quarter, selling approximately \$0.8 billion of specified pools HECM and dust bonds. We also continued to sell legacy non-agency bonds that we believe had reached full value. Importantly, at quarter-end, approximately 30% of our capital was dedicated to our operational businesses, up from 23% at June 30. This allocation includes retained interest from our securitizations, our loan pipeline, MSR and commercial real estate loans. The success of this capital transition is encouraging as we see higher expected returns in these endeavors.

Now let's turn to slide 11 and spend a moment on the conduit and MSR. During the third quarter, we sponsored two Agate Bay securitizations totaling \$606 million in UPB retaining approximately \$250 million of AAAs and approximately \$32 million of subordinate and IO bonds. Expected ROEs on these retained assets are in the low double digits.

Through our 10 securitization life to date, ABMT 2015-6, we have attracted over 45 different investors and believe this is the result of our Agate Bay brands growing acceptance in the marketplace.

Our pipeline, which includes loans and interest rate lock commitments, was robust at approximately \$1.2 billion at September 30. Finally, in late October, we sponsored ABMT 2015-7, a \$332 million securitization. We are very pleased with the progress we have made over the past few years in developing this important part of our business.



During the third quarter, we launched an expanded credit program targeting a more average borrower profile than our prime jumbo program. This program is in the very early stages of development and we will provide updates as it grows over time.

We made significant headway within our MSR business during the third quarter expanding our flow sale arrangements and adding approximately \$67 million in market value via bulk and flow purchases as Tom mentioned earlier. We believe the long-term success of our MSR business will be driven by the organic expansion of our flow sale arrangements within our originator partner network and have concentrated our resources on cultivating these relationships. We look forward to growing our MSR initiative during the remainder of 2015 and in the coming years.

Please turn to slide 12. We are particularly pleased with the progress we have made in our commercial real estate business. Our capital allocation increased to 4% as we added 8 loans during the quarter, 4 senior and 4 mezzanine. At September 30, we had a total of 9 loans on office, retail, multifamily and hotel properties throughout the United States with a total carrying value of \$291 million. We financed some of the senior loans with the FHLB subsequent to quarter-end and continue to build out multiple financing options to support this strategy.

As to deal flow, we are seeing excellent opportunities available in the marketplace today and are on schedule to deploy the initial \$500 million cap of capital to this business throughout the final months of this year and into 2016.

In closing, we aim to maintain a low risk profile as we transition our capital to what we believe are opportunities for higher-quality returns in our operational businesses. I will now turn the call back to Saeed to take any questions.

QUESTION AND ANSWER

Operator

Thank you. (Operator Instructions) Mark DeVries, Barclays.

Mark DeVries - Barclays Capital - Analyst

Yeah, thanks. This is one of the first quarters I can remember where there's a fair amount of volatility and you guys didn't actually materially outperform other mortgage REITs in terms of book value stability. Bill, I think you alluded to some of the causes around spread widening, things that made it hard to hedge, but could you just elaborate on some of those points and also talk about what you think the outlook is for some of the drivers that caused the book value volatility?

Bill Roth - Two Harbors Investment Corp. - CIO

Hey Mark, Good morning. Thanks for joining us today. So I think there were -- look, it was a very challenging quarter, as I think everyone, the analyst community, investor community, has all seen. I think there's a couple important drivers. First of all, obviously, mortgage has dramatically underperformed, agencies, that is. Swap spreads went negative to treasury. These are things you guys all know. Credit had a tough quarter. Residential credit outperformed high yield dramatically, but still suffered.

Additionally, we've kept our interest rate exposure really quite close, as you know and the market rallied quite a bit. So we didn't benefit from the rally after the Fed announced that you know, they sort of have been waffling back and forth. They are going to raise rates, they are not going to raise rates and so there's been a lot of volatility. If you were long duration, you benefited from that, but if you weren't and you were pretty close to home then you didn't benefit. So I think that is sort of one of the important differentiators.

So as you know looking back historically, we typically keep a pretty tight rein on our interest rate exposure and so when you do get these quarters for the market rallies, you know we don't intend to plan on benefiting from that, but conversely when it goes the other way, we would expect to outperform.

Mark DeVries - Barclays Capital - Analyst



Okay, that's helpful. And if I remember correctly, during the taper tantrum, you guys were pretty smart and out in front of that and you actually hedged the spread widening by just delevering -- selling down your agency positions. Are you at a point now where 40 [Act] compliance is limiting your ability to potentially hedge against further agency spread widening by selling down even more?

Bill Roth - Two Harbors Investment Corp. - CIO

Yes, no, that's a great question. That's something we obviously pay extremely close attention to and that's not something that we are ever to get remotely close to breaching. Obviously, if you sell an agency pool, it's a whole pool, your number goes down, but keep in mind the denominator goes down as well. So that's not something you should really spend a lot of time thinking about because that's not a test we are likely to come close to worrying about on our side.

Mark DeVries - Barclays Capital - Analyst

Okay, got it. Thanks.

Operator

Doug Harter, Credit Suisse.

Doug Harter - Credit Suisse - Analyst

Thanks, I guess sort of following on the volatility you saw on the hedging side, are you looking at the construction of your hedges and would you consider changing that to hedging more with treasuries against agencies, or will you stick with swaps?

Bill Roth - Two Harbors Investment Corp. - CIO

Hey, good morning Doug. If we had started the third quarter over again, yes. Going forward, that's a really tough question to ask because historically credit products typically track much more closely with swaps than they do with treasuries. You also have balance sheet considerations and funding considerations. If you switched, whatever, \$15 billion of swap hedges to \$15 billion of treasuries, your balance sheet goes up, you have to borrow those. So the combination of the fact that historically swaps -- in the short run, obviously, we've seen some dislocation, but historically that's really a great proxy for spread products.

Doug Harter - Credit Suisse - Analyst

Great. And for a while, you've been relatively lowly levered against the agency portfolio, not liking the market. Obviously, with spreads widening, are you closer to liking the market and potentially adding there or do you still sort of see yourself staying more cautious?

Bill Roth - Two Harbors Investment Corp. - CIO

Yes, so just to give you an idea, so agency spreads, we saw sort of ROEs and then we talked about this before, sort of in the mid-single digits, maybe a little bit better. I would say today they wind out -- there may be -- mid to high single digits, but frankly there's a number of reasons which we would not intend to increase that exposure and in fact, be more likely to move capital away. As you saw on slide 10, the agency exposure is going down.

And the reasons are, first of all and most importantly, the returns we are seeing in these other -- in CRE, MSR and the conduit are all in the double digits and that stuff we have a lot more control over. And so just on a mathematical basis, that's much more attractive than agency.

Second of all, to the extent that the Fed does finally increase interest rates at some point, there is a possibility that they decide that, on the follow, that they might start to not reinvest in agency mortgages. They've been the biggest driver of the nominal spread tightening that we've seen over the last several years. So you could certainly see that reverse itself. So the combination of relatively unattractive returns and the potential for wider spreads going forward, you should see that bucket continue to drop as opposed to increase.



I want to make one more comment on that swap spread versus treasury. Given that they've moved so negative, the other point I think it's worth mentioning is that if we were going to do that, this would not be the best time to make that switch.

Tom Siering - Two Harbors Investment Corp. - President & CEO

Yes, Doug, if we had done it at the beginning of the quarter, with the benefit of hindsight, it would have been great, but it seems like a very tricky entry point to us at these levels. There's really some funky dynamics going on between the interest rates and treasuries, so I think hedging with treasuries you would need to approach with great caution.

Doug Harter - Credit Suisse - Analyst

What do you think would get that relationship to normalize, or could we be looking at an environment where we are kind of out of step with normal for a while?

Bill Roth - Two Harbors Investment Corp. - CIO

Well, yes, I hope it's the latter. Frankly, a lot of it is just driven by the financing markets. Government repo is trading above LIBOR, so I think the movement in swap spreads, vis-a-vis treasuries, is highly a function of the financing markets. I don't know what turns that around, but going into year-end, you could certainly see some reasonable volatility. Now it could be the case that once we get past year-end, you see a little bit more normal conditions in the financing markets for government collateral in which case swap spreads could definitely start to move. I don't know if they go positive, but they certainly start to move wider.

Tom Siering - Two Harbors Investment Corp. - President & CEO

Yes, these are very unusual conditions right now, Doug.

Doug Harter - Credit Suisse - Analyst

Understood. Thank you.

Operator

Trevor Cranston, JMP securities.

Trevor Cranston - JMP Securities - Analyst

Hey, thanks. A couple questions on the MSR's. First, can you give us a sense of the origination capacity of the flow sellers you've been adding both during the third quarter and subsequent to quarter-end so that we can get a sense of the expected volume that could be coming onto the books?

Bill Roth - Two Harbors Investment Corp. - CIO

Yes, it's a little hard to get into the exact numbers currently because we added -- we basically went from 1 relationship earlier this year. Currently, we are at 6 and we intend to grow that through the remainder of this year and into next year, so it's a little hard to get into a glide path, if you will.

I think the one thing that's probably worth saying is if you -- we've said this now for the past several years -- that we could easily see 20% of capital in the MSR asset, which is roughly \$800 million and so we are only a little bit above half of that. So certainly, we have a lot of runway to continue to add and it's also -- I don't know -- maybe rates go lower, but certainly rates are reasonably low. So we don't think it's also a bad time to do that as well.



Tom Siering - Two Harbors Investment Corp. - President & CEO

Yes, I would just say, Trevor, that our seller network is expanding, so we would be reluctant to quantify a run rate in here for you, but it's something that we are working on, obviously developing and we have quite a bit of capacity for MSR.

Trevor Cranston - JMP Securities - Analyst

Okay, got it. Fair enough. And I know the flow sellers is kind of the key component of the strategy long term. But given the spread widening we saw across a variety of products over the last couple of quarters, did you guys see a material change in the pricing level of bulk MSRs and are you seeing those as more attractive over the near term? Thanks.

Bill Roth - Two Harbors Investment Corp. - CIO

Yes, so as you know, we are primarily focused on new issue conforming and the answer is no. We didn't really see any material change, so the interesting thing is just because agencies widen to swaps, they actually didn't do so poorly against treasuries and if you look at the mortgage rate, it's actually been reasonably stable for the last bulk of this year, frankly. So we really haven't seen a dramatic change in the mortgage rate and without huge volatility, you wouldn't expect to see MSR widen much and in fact, valuations have been relatively constant.

Trevor Cranston - JMP Securities - Analyst

Got it. Okay. Thank you.

Operator

Dan Altscher, FBR.

Dan Altscher - FBR Capital Markets - Analyst

Thanks and good morning, everyone. Bill, I think you started to touch a little bit on this and spent some time with Doug around what happened with swaps in the quarter. You started to touch on it a little bit, but can you maybe just give us your review generally just as to what you think is going on here that really caused, I guess, the historical deviation and what we would expect to see in swaps versus treasuries?

Bill Roth - Two Harbors Investment Corp. - CIO

Hey Dan, good morning. I think there's two key drivers. One of the drivers, especially for longer-dated spreads, is we've seen a huge amount of corporate issuance. What corporations do is typically they issue fixed and then they'll swap it back to floating and then they can manage their exposure along the curve. So clearly, you see a tremendous amount of receive interest and they are not going to go out and buy treasuries, that just doesn't make any sense for a corporation to do. So pressure on the longer end, a lot of that has been driven by corporate issuance on the receive side.

And then the other thing is the shorter-dated swap spreads have been much less volatile, although they've obviously been under pressure. And as I mentioned earlier, on the financing side, with GC trading much cheaper, if you run the math, typically, government collateral trades very low in rate and therefore, swap spreads need to be wider. But with GC cheapening up, then therefore the cost of having a treasury position, vis-a-vis a swap position, changes and so swap spreads come in.

Tom Siering - Two Harbors Investment Corp. - President & CEO

Yes, it's like anything else. One of the chief determinants of the value of anything is going to be the level that you can finance it and right now, that market for GC has been sloppy.



Dan Altscher - FBR Capital Markets - Analyst

Got it. Okay. Thanks. That's helpful to just discuss that. I wanted to talk a little bit just about FHLB. Have you heard any updates on the policy or the regulatory side as to where FHFA may be going or if there's anything towards the end of this year we could be looking for? Are we just going to kind of stick with what we have and know nothing?

Tom Siering - Two Harbors Investment Corp. - President & CEO

We really don't have anything new to report on that. So I wish I could provide you with some news, but we really have no fresh information on that. Our relationship with the (inaudible) continues to be excellent and that's a non-issue here, but we have nothing new to report in respect to the proposed rule-making changes.

Dan Altscher - FBR Capital Markets - Analyst

Okay. No, that's fine. And then just one other one. What was in last quarter's slide deck and I didn't see this quarter was kind of a reconciliation or a quick bar chart that showed, I guess, distributions relative to taxable income. I didn't see that reproduced in this quarter. So, Brad, is there maybe an update as to where you sit on the taxable income side versus distribution side?

Tom Siering - Two Harbors Investment Corp. - President & CEO

Yes, Brad, you are going to take that one, yes?

Brad Farrell - Two Harbors Investment Corp. - CFO & Treasurer

Appreciate the question. Last quarter, as you noted, we did provide some additional disclosure that we thought was very instructive at that point in time in the year about how we were kind of thinking about the latter half of the 2015 cycle and specifically calling out and making people aware of the realized gains and their impact. But really we don't intend to have that be a consistent disclosure. We'll obviously update at year-end, but we just didn't think the disclosure was very valuable this quarter given that we had really achieved our objective in disclosing that last quarter.

Dan Altscher - FBR Capital Markets - Analyst

Okay. Got it. Thanks. Appreciate it.

Operator

Joel Houck, Wells Fargo.

Joel Houck - Wells Fargo Securities - Analyst

Hey, good morning. Hate to beat up this swap spread issue to death, but I'll take another crack at it. It sounds like you're -- obviously, in hindsight, the hedging strategy would have been different, but you are reluctant to move to treasuries, which is understandable, but I guess the question is is that a sign that you believe that this unusual behavior swaps over the treasuries is more transitory, or is there something more systemic about this that might last into next year? I'm just curious as to your thoughts on that. And then I had a follow-up.

Tom Siering - Two Harbors Investment Corp. - President & CEO



Well, empirically, this is certainly an aberration and whether or not it is sustained is difficult to say. As Bill pointed out, two drivers of this have been corporate issuance and financing rates in respect of treasury collateral and it's difficult to say whether that's an ongoing phenomenon or not. Empirically, this is certainly an aberration what's going on in the spreads.

Joel Houck - Wells Fargo Securities - Analyst

Okay. Fair enough. Now would it not be also fair to think that maybe given the discount to book that given the uncertainty with agency, and I think Bill mentioned that you have plenty of room to take down the agency book for 40 Act purposes to not shrink that book and be more aggressive in stock buybacks given the discount that's opened up on a price-to-book basis?

Tom Siering - Two Harbors Investment Corp. - President & CEO

Yes, we are committed to buying back shares when it makes sense economically for our shareholders and obviously, we bought shares in the quarter and we will continue to buy shares when it makes sense for our stockholders. That is our commitment.

Joel Houck - Wells Fargo Securities - Analyst

Well, I guess maybe if I could, more directly, now would seem to be a good time. If you are worried about the Fed potentially shrinking its balance sheet and spread widening in agencies given the uncertainty over how to hedge that, it would seem to me that a good thing for shareholders would be to be more aggressive in buying back stock and shrinking at least the agency part.

I think your earlier comments were that the risk reward was much more favorable outside of agency. I don't think anybody disagrees with that. I am just questioning how the overall corporate strategy here doesn't sync up with what we are hearing in the conference call.

Tom Siering - Two Harbors Investment Corp. - President & CEO

Sure, absolutely. Well, I'm going to say this and I mean this very respectfully, it's not in the best interest of our shareholders to discuss with granularity our strategies around repurchasing shares. So we are committed to buying shares when it makes sense economically and we understand the math and -- but to talk with more granularity than that we don't think is in the best interest of our shareholders because obviously we want to not give guidance where we might be buying shares back. My job is to take care of shareholders and I believe it's best just not to discuss with granularity strategies around that.

Joel Houck - Wells Fargo Securities - Analyst

Okay. Just last question. Can you maybe give us an update on your -- with respect to the commercial real estate initiative, what infrastructure you have behind that in terms of origination and how you are sourcing commercial real estate loans?

Bill Roth - Two Harbors Investment Corp. - CIO

Yes, sure. Happy to do that. So as we mentioned, we built out the team in the first half of this year. There's roughly a dozen professionals in that group. Basically includes originators, underwriters, folks that are working on transaction management. And so basically what we are doing is sourcing loans either directly with borrowers that our group has had relationships with over the years or through real estate brokers. A lot of the market isn't brokered, as you probably know.

We have a tremendous pipeline. We look at a lot of deals. A lot of deals don't make the cut, but those that do, we spend a lot of time diligencing, underwriting, going out to see the property, running the numbers and then of that, some amount of them fall through the hoop and we close them and fund them. So it's a very classic structure with originators and underwriters basically doing the work.

Joel Houck - Wells Fargo Securities - Analyst



Okay, guys. Thanks for taking my questions.

Operator

Rick Shane, JPMorgan.

Rick Shane - JPMorganChase - Analyst

Hey, guys. Based on your comments or your responses to Joel's question, I'm not sure how far I'm going to get with what I'm about to ask you. I hear what you are saying about buyback and I understand that you don't want to telegraph specifically at what levels you are going to be buying back stock. But at the same time, I think framing this conversation is relevant to investors and is helpful to them.

And I guess the two things that I would love to think about are, without being specific in terms of this is the price at which you become aggressive, what are the considerations? Your stock is trading right now near its trough multiple of book. That, obviously, should be a consideration. I think the other thing that probably has to weigh into this is your implicit assumptions about whether or not the underlying assets are fairly or cheaply or overvalued. Can you talk a little bit about that?

And then at least put into some context the magnitude of what you would consider buying back. The buyback in the most recent quarter was about 30 basis points, so it's a signal to the market, but I would ascribe that it doesn't really move the dial in a big way and I would love to get a sense of how aggressive that could be.

Tom Siering - Two Harbors Investment Corp. - President & CEO

Sure. So we have -- how big it could be, we have 21.2 million shares remaining that are available for repurchase under our existing program. So today, that's the maximum amount it could be. But in respect of your first question, yes, I'm not going to get into more granularity about strategy. What I will say is this. How we look at it is say what are the investment opportunities in the spaces in which we operate and then we look at the math in respect of the stock price relative to book value.

So in a big-picture sense, if investment opportunities are amazing and our shares are trading near or through book value, that's not a good time to repurchase shares. Conversely, when market conditions are otherwise, when certain investment opportunities aren't that attractive and our shares are at a discount to book value, that's when it makes sense to repurchase shares. And as I said, we have an ongoing commitment to stay faithful to that methodology and honestly, I think that's all that it's appropriate for us to say today because we want to remain flexible in respect of our strategies around repurchasing shares. That's what's best for our shareholders, not to give particular guidance around that.

Rick Shane - JPMorganChase - Analyst

Okay. Thank you.

Operator

Brock Vandervliet, Nomura Securities.

Brock Vandervliet - Nomura Securities - Analyst

Thanks very much. Appreciate you guys all trying to explain the swap spread issue. I think the challenge that we all have is that every management in the space seems to be at pains to explain the drivers and when that may change. I guess a follow-on would be can you give, with the swap spreads kind of marching tighter almost every day, could you give any sort of an update on book value here to date in the quarter?

Tom Siering - Two Harbors Investment Corp. - President & CEO



Sure. It's our policy, unless book value moves meaningfully, not to discuss intra-quarter. Obviously, we are just about one month into the quarter. And so if there was any meaningful change, we would have said it today and we have not said it, so that's what we are prepared to say. There hasn't been a dramatic move in the market that should be noted at this time. Again, we are one month into the quarter, so that's -- there's two-thirds of it to be played out still but as of today there has not been a notable change in book value.

Brock Vandervliet - Nomura Securities - Analyst

Okay, fair enough. And as a follow-up, different topic on the two securitizations you executed, could you talk just about the execution that you got on those deals? I think I heard you retained half or so of the AAAs. Thanks.

Bill Roth - Two Harbors Investment Corp. - CIO

Good morning Brock this is Bill. We've been very happy with the execution on our deals generally. There have been some deals where we sold all the AAAs and there have been some deals where we sold some of the AAAs. Frankly that just comes down to clearing levels. If you pay any attention to where AAA spreads have been, they've been anywhere from in the mid to high 2s to mid to high 3s in terms of points back of pass-throughs. And so, obviously, it's probably fair to assume that when we are on the wider end that that looked pretty good to us and we weren't going to sell bonds at those levels.

I don't want to get into specifics because it kind of depends on any given day how cheap is the mortgage basis and what's the book look like, etc. There's, obviously, been, as you've probably heard on other calls, there are certain times where these AAAs get really very cheap and a lot of people want them and that's a time where we want them too. So we are happy to retain them when we think they are double-digit ROEs for us.

Brock Vandervliet - Nomura Securities - Analyst

Okay, thanks for taking my questions.

Operator

Mike Widner, KBW.

Mike Widner - Keefe, Bruyette & Woods - Analyst

Good morning, guys. I'm not going to ask anything about swap spreads, but I do want to ask you about -- if you could just talk conceptually about your core earnings, your expectations with respect to the dividend. I guess specifically how I would prefix that is, since the taper tantrum, about two years now, your core earnings have been averaging very close to what this quarter was. And then you mentioned in the opening comments that \$0.22 core was very much in line with your expectations. So if \$0.22 has been the run rate, it's kind of where you guys expected this quarter to be. Could you just talk about that relative to the \$0.26 dividend and how should we should think about that going forward?

Tom Siering - Two Harbors Investment Corp. - President & CEO

Sure. Thanks for the question. We've often said that core earnings are not a perfect metric in respect of and really in any sense in respect of our ability to pay the dividend. So the dividend is determined by several things typically, but this year it's really been more of a story of taxable income and obviously, in respect of that, we need to be compliant with REIT rules. And so in no way should you take this as guidance, but in that respect we are in good shape coming into the year-end.

But we are a month into the quarter. The determination of the dividend has not been determined yet. Obviously, we have projections, but we've been reluctant to historically, for all the right reasons, to be loathe to give dividend guidance and so you should anticipate that that's going to be our philosophy going forward as well.

Mike Widner - Keefe, Bruyette & Woods - Analyst



I appreciate that. Certainly makes sense. I guess let me -- because you guys talked a little bit more about taxable last quarter and a little less this quarter, I think. So I don't really think too many people care much about the Q4 dividend. I think it's more thinking about 2016 and ahead. I guess really maybe my question is do you expect a systemic spread between taxable and core? And again, if it's \$0.04, any reason to think that that would change, that the core might better reflect or be closer to taxable going forward, if that question makes sense?

Tom Siering - Two Harbors Investment Corp. - President & CEO

Well, I'd say this with all good humor. If I am reluctant to give guidance into the fourth quarter, I'm really reluctant to give guidance into 2016. The mortgage market conditions are temporal. So if you look at what's going to drive the dividend over the long term, it's going to be the earning power of the portfolio, which is a function of earnings and capital gains and so forth. And if you look at agency spreads historically, they are pretty unattractive, mediocre I would characterize them at. But conditions can change a lot. So what 2016 brings is going to be difficult for us to say.

And the drivers of the dividend can change over time. As I said in my prior remarks, 2015 has largely been a story of taxable income, but, in 2016, there will be other drivers that determine the dividend as well.

Mike Widner - Keefe, Bruyette & Woods - Analyst

Yes, certainly. I certainly get that. I guess specifically is there some reason that we would expect, based on the current mix of assets and businesses and the operating businesses, that we should expect a systemic sort of spread between core and taxable? As an analyst, it's very difficult to predict taxable because we are not tax accountants and like you said, there can be very difficult things to predict that -- again, predicting GAAP versus core versus taxable is three different things and I don't really feel like I personally have as great of visibility into taxable as perhaps the other two and that's why just the question, whether there's something systemic that leads to a spread that taxable will for years run above core.

Tom Siering - Two Harbors Investment Corp. - President & CEO

Sure. So I'm going to let Brad handle the accounting aspect of that question, but I would just say that our transition into these new businesses, they have better ROEs and so that's why we are making the transition and frankly, in many respects, we think they are higher-quality ROEs. But that's not to say -- it's difficult to say what the future holds. But that is why we are making the transition. The ROEs are better in that business, which is obviously better to support the dividend, but again we are not going to give any guidance. With that, I'm going to hand it over to Brad for the tax aspect of your question.

Brad Farrell - Two Harbors Investment Corp. - CFO & Treasurer

Yes, I will probably a little repeat -- I think I will hit two points. One, you are kind of referring to the delta between taxable income and core and the largest driver of that is us exiting or selling certain agency securities, non-agency securities that we hold and to project what that will be is just not feasible.

But bigger picture, we sold nearly \$1 billion of agency securities this quarter, shifted that capital to other forms of assets, commercial, prime jumbo loans that will generate incremental core earnings and at the same time that does generate realized gains. So kind of taking a step back, yes, in so far we harvest and shift capital, there will be realized gains, which will drive the higher taxable income and create a delta between core earnings.

Meanwhile, we are working very, very diligently to shift our capital to asset classes that are generating incremental ROE, which will then drive up core earnings. I think those are the two big trends that we are working very hard and trying to be transparent about what we are trying to achieve.

Mike Widner - Keefe, Bruyette & Woods - Analyst

Okay. I appreciate that. And I think really one of your points there sort of hits the real question, which again I am not looking for core guidance, it's more about the delta between the two and it sounds like the majority of that is really just the realized gain component, understanding that's a part of your model. I understand it's going to be inherently unpredictable, but I do appreciate all the comments. Thanks.

Tom Siering - Two Harbors Investment Corp. - President & CEO



Yes, especially, if I could just add one final comment. In the non-agency space, we've had some capital gains in 2015 because prices have advanced over the last couple years. But really our philosophy around that is not to (technical difficulty) capital gains per se. Really what we are doing is selling bonds when we think they no longer make economic sense to hold and in 2015, there were capital gains derived from that, but the philosophy is not to generate capital gains per se, but rather to make smart investment decisions for our shareholders.

Mike Widner - Keefe, Bruyette & Woods - Analyst

Yes. Understood. Appreciate the comments as always, guys. Thank you.

Operator

I would like to hand the conference over to Mr. Tom Siering for closing remarks.

Tom Siering - Two Harbors Investment Corp. - President & CEO

Thanks, Saeed. Thank you for joining our earnings call today. We are quite pleased with the advancements we've made in our business lines and are excited for the future of the Company. As a reminder, last night, we launched the 8th webinar in our ongoing series titled Mortgage Loan Conduit and Securitization. It can be found at www.twoharborsinvestment.com under the Investors and Webinars links. We hope you find it instructive and we thank you for your interest in Two Harbors. Have a wonderful day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes our program for today. You may all disconnect. Have a wonderful day.

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