

Orchid Island Capital, Inc.
Form 10-Q
November 01, 2016

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

FORM 10-Q

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

For the quarterly period ended September 30, 2016

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: 001-35236
Orchid Island Capital, Inc.
(Exact name of registrant as specified in its charter)
Maryland 27-3269228
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

3305 Flamingo Drive, Vero Beach, Florida 32963
(Address of principal executive offices) (Zip Code)

(772) 231-1400
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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 12b2 of the Exchange Act.

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

Number of shares outstanding at November 1, 2016: 26,252,193

ORCHID ISLAND CAPITAL, INC.

TABLE OF CONTENTS

	Page
PART I. FINANCIAL INFORMATION	
ITEM 1. Condensed Financial Statements	1
Balance Sheets as of September 30, 2016 (unaudited) and December 31, 2015	1
Statements of Operations (unaudited) for the nine and three months ended September 30, 2016 and 2015	2
Statement of Stockholders' Equity (unaudited) for the nine months ended September 30, 2016	3
Statements of Cash Flows (unaudited) for the nine months ended September 30, 2016 and 2015	4
ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	25
ITEM 3. Quantitative and Qualitative Disclosures about Market Risk	45
ITEM 4. Controls and Procedures	48
PART II. OTHER INFORMATION	
ITEM 1. Legal Proceedings	49
ITEM 1A. Risk Factors	49
ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds	49
ITEM 3. Defaults upon Senior Securities	49
ITEM 4. Mine Safety Disclosures	49
ITEM 5. Other Information	49
ITEM 6. Exhibits	50
SIGNATURES	51

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED FINANCIAL STATEMENTS

ORCHID ISLAND CAPITAL, INC.
CONSOLIDATED BALANCE SHEETS
(\$ in thousands, except per share data)

	(Unaudited)	
	September 30, 2016	December 31, 2015
ASSETS:		
Mortgage-backed securities, at fair value		
Pledged to counterparties	\$2,404,113	\$2,095,574
Unpledged	97,384	62,436
Total mortgage-backed securities	2,501,497	2,158,010
Cash and cash equivalents	110,860	57,229
Restricted cash	16,881	12,730
Accrued interest receivable	9,527	8,490
Derivative assets, at fair value	1,097	669
Receivable for securities sold, pledged to counterparties	27,509	-
Other assets	1,100	4,709
Total Assets	\$2,668,471	\$2,241,837

LIABILITIES AND STOCKHOLDERS' EQUITY

LIABILITIES:		
Repurchase agreements	\$2,298,097	\$1,798,813
FHLB advances	-	187,500
Payable for unsettled securities purchased	72,343	-
Derivative liabilities, at fair value	545	-
Accrued interest payable	1,873	863
Due to affiliates	480	465
Other liabilities	737	941
Total Liabilities	2,374,075	1,988,582

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY:

Preferred stock, \$0.01 par value; 100,000,000 shares authorized; no shares issued and outstanding as of September 30, 2016 and December 31, 2015	-	-
Common Stock, \$0.01 par value; 500,000,000 shares authorized, 26,252,193 shares issued and outstanding as of September 30, 2016 and 21,749,490 shares issued and outstanding as of December 31, 2015	263	217
Additional paid-in capital	294,133	253,038
Total Stockholders' Equity	294,396	253,255
Total Liabilities and Stockholders' Equity	\$2,668,471	\$2,241,837
See Notes to Consolidated Financial Statements		

ORCHID ISLAND CAPITAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

For the Nine and Three Months Ended September 30, 2016 and 2015

(\$ in thousands, except per share data)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2016	2015	2016	2015
Interest income	\$62,059	\$49,719	\$22,358	\$18,352
Interest expense	(10,629)	(4,900)	(3,979)	(2,037)
Net interest income	51,430	44,819	18,379	16,315
Realized gains (losses) on mortgage-backed securities	4,482	(1,073)	229	850
Unrealized gains (losses) on mortgage-backed securities	5,652	(9,029)	(2,398)	(2,026)
(Losses) gains on derivative instruments	(32,594)	(35,660)	6,587	(22,506)
FHLB stock dividends	14	-	-	-
Net portfolio income (loss)	28,984	(943)	22,797	(7,367)
Expenses:				
Management fees	2,968	2,929	1,052	1,061
Allocated overhead	963	774	336	260
Accrued incentive compensation	598	484	212	162
Directors' fees and liability insurance	763	732	236	250
Audit, legal and other professional fees	654	493	193	160
Direct REIT operating expenses	426	174	187	86
Other administrative	215	209	55	71
Total expenses	6,587	5,795	2,271	2,050
Net income (loss)	\$22,397	\$(6,738)	\$20,526	\$(9,417)
Basic and diluted net income (loss) per share	\$0.99	\$(0.34)	\$0.85	\$(0.42)
Weighted Average Shares Outstanding	22,619,293	19,725,675	24,133,343	22,545,019
Dividends declared per common share	\$1.26	\$1.50	\$0.42	\$0.42
See Notes to Consolidated Financial Statements				

ORCHID ISLAND CAPITAL, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(Unaudited)

For the Nine Months Ended September 30, 2016

(\$ in thousands, except per share data)

	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Total
Balances, January 1, 2016	\$ 217	\$253,038	\$-	\$253,255
Net income	-	-	22,397	22,397
Cash dividends declared, \$1.26 per share	-	(6,467)	(22,397)	(28,864)
Issuance of common stock pursuant to public offerings, net	46	47,070	-	47,116
Issuance of common stock pursuant to stock based compensation plan	-	271	-	271
Amortization of stock based compensation	-	221	-	221
Balances, September 30, 2016	\$ 263	\$294,133	\$-	\$294,396
See Notes to Consolidated Financial Statements				

ORCHID ISLAND CAPITAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

For the Nine Months Ended September 30, 2016 and 2015

(\$ in thousands)

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$22,397	\$(6,738)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Stock based compensation	492	364
Realized and unrealized (gains) losses on mortgage-backed securities	(10,134)	10,102
Realized (gains) losses on interest rate swaptions	(36)	1,217
Unrealized (gains) losses on interest rate swaps	(792)	-
Realized losses (gains) on forward settling to-be-announced securities	2,385	(24)
Changes in operating assets and liabilities:		
Accrued interest receivable	(967)	(1,973)
Other assets	(93)	(488)
Accrued interest payable	1,010	(176)
Other liabilities	(204)	9
Due to affiliates	15	89
NET CASH PROVIDED BY OPERATING ACTIVITIES	14,073	2,382
CASH FLOWS FROM INVESTING ACTIVITIES:		
From mortgage-backed securities investments:		
Purchases	(2,184,709)	(2,106,110)
Sales	1,717,612	1,364,754
Principal repayments	178,460	166,910
Redemption of FHLB stock	3,750	-
Increase in restricted cash	(4,151)	(3,444)
(Payments on) proceeds from net settlement of to-be-announced securities	(2,145)	24
Purchase of interest rate swaptions, net of margin cash received	705	(1,364)
NET CASH USED IN INVESTING ACTIVITIES	(290,478)	(579,230)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from repurchase agreements	22,443,458	13,608,591
Principal payments on repurchase agreements	(21,944,174)	(13,101,943)
Principal payments on FHLB advances	(187,500)	-
Cash dividends	(28,864)	(29,598)
Proceeds from issuance of common stock, net of issuance costs	47,116	83,275
Common stock repurchases	-	(9,512)
NET CASH PROVIDED BY FINANCING ACTIVITIES	330,036	550,813
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	53,631	(26,035)
CASH AND CASH EQUIVALENTS, beginning of the period	57,229	93,137
CASH AND CASH EQUIVALENTS, end of the period	\$110,860	\$67,102
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$9,619	\$5,076

SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES:

Securities acquired settled in later period	\$72,343	\$92,325
Securities sold settled in later period	27,509	87,558
See Notes to Consolidated Financial Statements		

-4-

ORCHID ISLAND CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
SEPTEMBER 30, 2016

NOTE 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Business Description

Orchid Island Capital, Inc. ("Orchid" or the "Company"), was incorporated in Maryland on August 17, 2010 for the purpose of creating and managing a leveraged investment portfolio consisting of residential mortgage-backed securities ("RMBS"). From incorporation to February 20, 2013 Orchid was a wholly owned subsidiary of Bimini Capital Management, Inc. ("Bimini"). Orchid began operations on November 24, 2010 (the date of commencement of operations). From incorporation through November 24, 2010, Orchid's only activity was the issuance of common stock to Bimini.

On February 20, 2013, Orchid completed the initial public offering ("IPO") of its common stock in which it sold approximately 2.4 million shares of its common stock and raised gross proceeds of \$35.4 million, which were invested in RMBS that were issued and the principal and interest of which were guaranteed by a federally chartered corporation or agency ("Agency RMBS") on a leveraged basis. Orchid is an "emerging growth company" as defined in the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act").

Orchid completed a secondary offering of 1,800,000 shares of common stock on January 23, 2014. The underwriters exercised their overallotment option in full for an additional 270,000 shares on January 29, 2014. The aggregate net proceeds to Orchid were approximately \$24.2 million which were invested in Agency RMBS on a leveraged basis.

Orchid completed a secondary offering of 3,200,000 shares of common stock shares on March 24, 2014. The underwriters exercised their overallotment option in full for an additional 480,000 shares on April 11, 2014. The aggregate net proceeds to Orchid were approximately \$44.0 million which were invested in Agency RMBS on a leveraged basis.

On June 17, 2014, Orchid entered into an equity distribution agreement (the "June 2014 Equity Distribution Agreement") with two sales agents pursuant to which the Company could offer and sell, from time to time, up to an aggregate amount of \$35,000,000 of shares of the Company's common stock in transactions that were deemed to be "at the market" offerings and privately negotiated transactions. The Company issued a total of 2,528,416 shares under the June 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$34.2 million, net of commissions and fees, prior to its termination in September 2014.

On September 3, 2014, Orchid entered into a second equity distribution agreement (the "September 2014 Equity Distribution Agreement") with two sales agents pursuant to which the Company could offer and sell, from time to time, up to an aggregate amount of \$75,000,000 of shares of the Company's common stock in transactions that are deemed to be "at the market" offerings and privately negotiated transactions. The September 2014 Equity Distribution Agreement replaced the June 2014 Equity Distribution Agreement. The Company issued a total of 5,087,646 shares under the September 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$69.1 million, net of commissions and fees, prior to its termination in March 2015.

On March 2, 2015, Orchid entered into a third equity distribution agreement (the "March 2015 Equity Distribution Agreement") with two sales agents pursuant to which the Company may offer and sell, from time to time, up to an aggregate amount of \$100,000,000 of shares of the Company's common stock in transactions that are deemed to be "at the market" offerings and privately negotiated transactions. The March 2015 Equity Distribution Agreement replaced the September 2014 Equity Distribution Agreement. The Company issued a total of 7,218,766 shares under the

March 2015 Equity Distribution Agreement for aggregate proceeds of approximately \$93.2 million, net of commissions and fees, prior to its termination in July 2016.

-5-

Edgar Filing: Orchid Island Capital, Inc. - Form 10-Q

On July 29, 2015 the Company's Board of Directors authorized the repurchase of up to 2,000,000 shares of the Company's common stock. The timing, manner, price and amount of any repurchases will be determined by the Company in its discretion and will be subject to economic and market conditions, stock price, applicable legal requirements and other factors. The authorization does not obligate the Company to acquire any particular amount of common stock and the program may be suspended or discontinued at the Company's discretion without prior notice. From the inception of the share repurchase program through September 30, 2016, the Company repurchased a total of 1,216,243 shares at an aggregate cost of approximately \$10.8 million, including commissions and fees.

On July 29, 2016, Orchid entered into a fourth equity distribution agreement (the "July 2016 Equity Distribution Agreement") with two sales agents pursuant to which the Company may offer and sell, from time to time, up to an aggregate amount of \$125,000,000 of shares of the Company's common stock in transactions that are deemed to be "at the market" offerings and privately negotiated transactions. The July 2016 Equity Distribution Agreement replaced the March 2015 Equity Distribution Agreement. Through September 30, 2016, the Company issued a total of 3,467,891 shares under the July 2016 Equity Distribution Agreement for aggregate proceeds of approximately \$37.0 million, net of commissions and fees.

Basis of Presentation and Use of Estimates

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The consolidated financial statements include the accounts of our wholly-owned subsidiary, Orchid Island Casualty, LLC. Significant intercompany accounts and transactions have been eliminated. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine and three month periods ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

The balance sheet at December 31, 2015 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. For further information, refer to the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The significant estimates affecting the accompanying financial statements are the fair values of RMBS and derivatives.

Statement of Comprehensive Income (Loss)

In accordance with the Financial Accounting Standards Board (the "FASB") Accounting Standards Codification ("ASC") Topic 220, Comprehensive Income, a statement of comprehensive income (loss) has not been included as the Company has no items of other comprehensive income (loss). Comprehensive income (loss) is the same as net income (loss) for the periods presented.

Cash and Cash Equivalents and Restricted Cash

Cash and cash equivalents include cash on deposit with financial institutions and highly liquid investments with original maturities of three months or less at the time of purchase. Restricted cash includes cash pledged as collateral for repurchase agreements and other borrowings, and interest rate swaps and other derivative instruments.

The Company maintains cash balances at four banks, and, at times, balances may exceed federally insured limits. The Company has not experienced any losses related to these balances. The Federal Deposit Insurance Corporation insures eligible accounts up to \$250,000 per depositor at each financial institution. At September 30, 2016, the Company's cash deposits exceeded federally insured limits by approximately \$108.8 million. Restricted cash balances are uninsured, but are held in separate customer accounts that are segregated from the general funds of the counterparty. The Company limits uninsured balances to only large, well-known bank and derivative counterparties and believes that it is not exposed to any significant credit risk on cash and cash equivalents or restricted cash balances.

Mortgage-Backed Securities

The Company invests primarily in mortgage pass-through ("PT") certificates, collateralized mortgage obligations, and interest only ("IO") securities and inverse interest only ("IIO") securities representing interest in or obligations backed by pools of RMBS. The Company has elected to account for its investment in RMBS under the fair value option. Electing the fair value option requires the Company to record changes in fair value in the consolidated statement of operations, which, in management's view, more appropriately reflects the results of our operations for a particular reporting period and is consistent with the underlying economics and how the portfolio is managed.

The Company records RMBS transactions on the trade date. Security purchases that have not settled as of the balance sheet date are included in the RMBS balance with an offsetting liability recorded, whereas securities sold that have not settled as of the balance sheet date are removed from the RMBS balance with an offsetting receivable recorded.

The fair value of the Company's investments in RMBS is governed by FASB ASC 820, Fair Value Measurement. The definition of fair value in FASB ASC 820 focuses on the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date. The fair value measurement assumes that the transaction to sell the asset or transfer the liability either occurs in the principal market for the asset or liability, or in the absence of a principal market, occurs in the most advantageous market for the asset or liability. Estimated fair values for RMBS are based on independent pricing sources and/or third party broker quotes, when available.

Income on PT RMBS securities is based on the stated interest rate of the security. Premiums or discounts present at the date of purchase are not amortized. Premium lost and discount accretion resulting from monthly principal repayments are reflected in unrealized gains (losses) on RMBS in the consolidated statements of operations. For IO securities, the income is accrued based on the carrying value and the effective yield. The difference between income accrued and the interest received on the security is characterized as a return of investment and serves to reduce the asset's carrying value. At each reporting date, the effective yield is adjusted prospectively from the reporting period based on the new estimate of prepayments and the contractual terms of the security. For IIO securities, effective yield and income recognition calculations also take into account the index value applicable to the security. Changes in fair value of RMBS during each reporting period are recorded in earnings and reported as unrealized gains or losses on mortgage-backed securities in the accompanying consolidated statements of operations.

FHLB Stock

The Company's wholly-owned subsidiary, Orchid Island Casualty, LLC, is a member of, and owns capital stock in, the Federal Home Loan Bank of Cincinnati ("FHLBC"). As a condition of its membership in the FHLBC, the subsidiary is required to maintain a FHLBC stock investment, both for membership and for the level of advances from the FHLBC to the subsidiary. The Company accounts for its investment in FHLBC stock as a cost method investment in "Other assets". The Company periodically evaluates FHLBC stock for impairment in accordance with ASC 320. See Note 3 for more information about the subsidiary's membership in the FHLBC.

Derivative Financial Instruments

The Company uses derivative instruments to manage interest rate risk, facilitate asset/liability strategies and manage other exposures, and it may continue to do so in the future. The principal instruments that the Company has used to date are T-Note and Eurodollar futures contracts, interest rate swaps, and options to enter in interest rate swaps ("interest rate swaptions"), but may enter into other derivatives in the future.

The Company purchases a portion of its Agency RMBS through forward settling transactions, including "to-be-announced" ("TBA") securities transactions. At times when market conditions are conducive, the Company may choose to move the settlement of these TBA securities transactions out to a later date by entering into an offsetting short position, which is then net settled for cash, and simultaneously entering into a substantially similar TBA securities trade for a later settlement date. Such a set of transactions is referred to as a TBA "dollar roll" transaction. The TBA securities purchased at the later settlement date are typically priced at a discount to securities for settlement in the current month. This difference is referred to as the "price drop." The price drop represents compensation to the Company for foregoing net interest margin and is referred to as TBA "dollar roll income." Specified pools of mortgage loans can also be the subject of a dollar roll transaction, when market conditions allow.

The Company accounts for TBA securities as derivative instruments if either the TBA securities do not settle in the shortest period of time possible or if the Company cannot assert that it is probable at inception of the TBA transaction, or throughout its term, that it will take physical delivery of the Agency RMBS for a long position, or make delivery of the Agency RMBS for a short position, upon settlement of the trade. The Company accounts for TBA dollar roll transactions as a series of derivative transactions. Gains, losses and dollar roll income associated with TBA securities transactions and dollar roll transactions are reported in gain (loss) on derivative instruments in the accompanying consolidated statements of operations. The fair value of TBA securities is estimated based on similar methods used to value RMBS securities.

The Company has elected not to treat any of its derivative financial instruments as hedges in order to align the accounting treatment of its derivative instruments with the treatment of its portfolio assets under the fair value option election. FASB ASC Topic 815, Derivatives and Hedging, requires that all derivative instruments be carried at fair value. Changes in fair value are recorded in earnings for each period.

Holding derivatives creates exposure to credit risk related to the potential for failure on the part of counterparties and exchanges to honor their commitments. In addition, the Company may be required to post collateral based on any declines in the market value of the derivatives. In the event of default by a counterparty, the Company may have difficulty recovering its collateral and may not receive payments provided for under the terms of the agreement. To mitigate this risk, the Company uses only well-established commercial banks as counterparties.

Financial Instruments

FASB ASC 825, Financial Instruments, requires disclosure of the fair value of financial instruments for which it is practicable to estimate that value, either in the body of the financial statements or in the accompanying notes. RMBS, Eurodollar and T-Note futures contracts, interest rate swaps, interest rate swaptions and TBA securities are accounted for at fair value in the consolidated balance sheets. The methods and assumptions used to estimate fair value for these instruments are presented in Note 12 of the consolidated financial statements.

The estimated fair value of cash and cash equivalents, restricted cash, accrued interest receivable, receivable for securities sold, other assets, due to affiliates, repurchase agreements, payable for unsettled securities purchased, accrued interest payable and other liabilities generally approximates their carrying values as of September 30, 2016 and December 31, 2015 due to the short-term nature of these financial instruments.

Repurchase Agreements

The Company finances the acquisition of the majority of its RMBS through the use of repurchase agreements under master repurchase agreements. Pursuant to ASC Topic 860, Transfers and Servicing, the Company accounts for repurchase transactions as collateralized financing transactions, which are carried at their contractual amounts, including accrued interest, as specified in the respective agreements.

Manager Compensation

The Company is externally managed by Bimini Advisors, LLC (the "Manager" or "Bimini Advisors"), a Maryland limited liability company and wholly-owned subsidiary of Bimini. The Company's management agreement with the Manager provides for payment to the Manager of a management fee and reimbursement of certain operating expenses, which are accrued and expensed during the period for which they are earned or incurred. Refer to Note 13 for the terms of the management agreement.

Earnings Per Share

The Company follows the provisions of FASB ASC 260, Earnings Per Share. Basic earnings per share ("EPS") is calculated as net income or loss attributable to common stockholders divided by the weighted average number of shares of common stock outstanding or subscribed during the period. Diluted EPS is calculated using the treasury stock or two-class method, as applicable, for common stock equivalents, if any. However, the common stock equivalents are not included in computing diluted EPS if the result is anti-dilutive.

Income Taxes

Orchid has qualified and elected to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Code"). REITs are generally not subject to federal income tax on their REIT taxable income provided that they distribute to their stockholders at least 90% of their REIT taxable income on an annual basis. In addition, a REIT must meet other provisions of the Code to retain its tax status.

Orchid measures, recognizes and presents its uncertain tax positions in accordance with FASB ASC 740, Income Taxes. Under that guidance, Orchid assesses the likelihood, based on their technical merit, that tax positions will be sustained upon examination based on the facts, circumstances and information available at the end of each period. All of Orchid's tax positions are categorized as highly certain. There is no accrual for any tax, interest or penalties related to Orchid's tax position assessment. The measurement of uncertain tax positions is adjusted when new information is available, or when an event occurs that requires a change.

Recent Accounting Pronouncements

In August 2016, the FASB issued Accounting Standards Update ("ASU") 2016-15, Statement of Cash Flows – (Topic 230): Classification of Certain Cash Receipts and Cash Payments. ASU 2016-15 addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. ASU 2016-15 is effective for fiscal years, and for interim periods within those years, beginning after December 15, 2017. Early application is permitted. The Company is currently evaluating the potential effect of this ASU on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (CECL) model). ASU 2016-13 is effective for fiscal years, and for interim periods within those years, beginning after December 15, 2019. Early application is permitted for fiscal periods beginning after December 15, 2018. The Company is currently evaluating the potential effect of this ASU on its consolidated financial

statements.

-9-

In January 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 provides guidance for the recognition, measurement, presentation and disclosure of financial assets and financial liabilities. ASU 2016-01 is effective for fiscal years, and for interim periods within those years, beginning after December 15, 2017 and, for most provisions, is effective using the cumulative-effect transition approach. Early application is permitted for certain provisions. The Company is currently evaluating the potential effect of this ASU on its consolidated financial statements.

In June 2014, the FASB issued ASU 2014-12, Compensation-Stock Compensation: Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. ASU 2014-12 requires that performance targets that affect vesting and that could be achieved after the requisite service period be treated as performance conditions. The effective date of ASU 2014-12 is for interim and annual reporting periods beginning after December 15, 2015. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

NOTE 2. MORTGAGE-BACKED SECURITIES

The following table presents the Company's RMBS portfolio as of September 30, 2016 and December 31, 2015:

(in thousands)

	September 30, 2016	December 31, 2015
Pass-Through RMBS Certificates:		
Hybrid Adjustable-rate Mortgages	\$48,764	\$52,238
Adjustable-rate Mortgages	2,076	2,976
Fixed-rate Mortgages	2,332,879	2,000,623
Total Pass-Through Certificates	2,383,719	2,055,837
Structured RMBS Certificates:		
Interest-Only Securities	51,174	61,574
Inverse Interest-Only Securities	66,604	40,599
Total Structured RMBS Certificates	117,778	102,173
Total	\$2,501,497	\$2,158,010

The following table summarizes the Company's RMBS portfolio as of September 30, 2016 and December 31, 2015, according to the contractual maturities of the securities in the portfolio. Actual maturities of RMBS investments are generally shorter than stated contractual maturities and are affected by the contractual lives of the underlying mortgages, periodic payments of principal, and prepayments of principal.

(in thousands)

	September 30, 2016	December 31, 2015
Greater than one year and less than five years	\$202	\$-
Greater than five years and less than ten years	280	835
Greater than or equal to ten years	2,501,015	2,157,175
Total	\$2,501,497	\$2,158,010

The Company generally pledges its RMBS assets as collateral under repurchase agreements. At September 30, 2016 and December 31, 2015, the Company had unpledged securities totaling \$97.4 million and \$62.4 million, respectively. The unpledged balance at September 30, 2016 includes unsettled security purchases with a fair value of approximately \$72.5 million that will be pledged as collateral under repurchase agreements on their respective settlement dates in October 2016.

NOTE 3. REPURCHASE AGREEMENTS AND OTHER BORROWINGS

The Company pledges certain of its RMBS as collateral under repurchase agreements with financial institutions. Interest rates are generally fixed based on prevailing rates corresponding to the terms of the borrowings, and interest is generally paid at the termination of a borrowing. If the fair value of the pledged securities declines, lenders will typically require the Company to post additional collateral or pay down borrowings to re-establish agreed upon collateral requirements, referred to as "margin calls." Similarly, if the fair value of the pledged securities increases, lenders may release collateral back to the Company. As of September 30, 2016, the Company had met all margin call requirements.

Repurchase Agreements

As of September 30, 2016, the Company had outstanding repurchase obligations of approximately \$2,298.1 million with a net weighted average borrowing rate of 0.73%. These agreements were collateralized by RMBS with a fair value, including accrued interest and securities pledged related to securities sold but not yet settled, of approximately \$2,431.3 million, and cash pledged to the counterparties of approximately \$8.1 million. As of December 31, 2015, the Company had outstanding repurchase obligations of approximately \$1,798.8 million with a net weighted average borrowing rate of 0.64%. These agreements were collateralized by RMBS with a fair value, including accrued interest, of approximately \$1,909.3 million, and cash pledged to the counterparties of approximately \$4.0 million.

As of September 30, 2016 and 2015, the Company's repurchase agreements had remaining maturities as summarized below:

(\$ in thousands)

	OVERNIGHT (1 DAY OR LESS)	BETWEEN 2 AND 30 DAYS	BETWEEN 31 AND 90 DAYS	TOTAL
September 30, 2016				
Fair market value of securities pledged, including accrued interest receivable	\$ -	\$ 2,379,715	\$ 51,561	\$ 2,431,276
Repurchase agreement liabilities associated with these securities	\$ -	\$ 2,248,871	\$ 49,226	\$ 2,298,097
Net weighted average borrowing rate	-	0.73 %	0.71 %	0.73 %
December 31, 2015				
Fair market value of securities pledged, including accrued interest receivable	\$ -	\$ 1,894,491	\$ 14,801	\$ 1,909,292
Repurchase agreement liabilities associated with these securities	\$ -	\$ 1,789,338	\$ 9,475	\$ 1,798,813
Net weighted average borrowing rate	-	0.64 %	1.19 %	0.64 %

If, during the term of a repurchase agreement, a lender files for bankruptcy, the Company might experience difficulty recovering its pledged assets, which could result in an unsecured claim against the lender for the difference between the amount loaned to the Company plus interest due to the counterparty and the fair value of the collateral pledged to such lender, including the accrued interest receivable and cash posted by the Company as collateral. At September 30, 2016, the Company had an aggregate amount at risk (the difference between the amount loaned to the Company, including interest payable and securities posted by the counterparty (if any), and the fair value of securities and cash pledged (if any), including accrued interest on such securities) with all counterparties of approximately \$139.4 million. The Company did not have an amount at risk with any individual counterparty greater than 10% of the Company's equity at September 30, 2016 and December 31, 2015.

FHLB Advances

In December 2015, our wholly-owned subsidiary, Orchid Island Casualty, LLC, was accepted for membership in the FHLBC. As of December 31, 2015, our subsidiary had approximately \$187.5 million of outstanding secured FHLB advances, with a weighted average borrowing rate of 0.42%. These advances were secured by RMBS with a fair value, including accrued interest, of approximately \$192.2 million as of December 31, 2015. This agreement also required our subsidiary to purchase and hold stock in the FHLBC in an amount equal to a specified percentage of outstanding advances. As of December 31, 2015, our subsidiary held FHLBC stock with a cost basis of approximately \$3.8 million which is included in other assets in our consolidated balance sheets.

On January 12, 2016, the regulator of the FHLB system, the Federal Housing Finance Agency ("FHFA"), released a final rule that amended regulations governing FHLB membership, including an amendment which prevents captive insurance companies from being eligible for FHLB membership. Under the terms of the final rule, our subsidiary is required to terminate its membership, redeem existing FHLBC stock, and repay its existing advances within one year following the effective date of the final rule. In addition, our subsidiary is prohibited from obtaining new advances or renewing existing advances upon their maturity during the one year transition period. The final rule became effective on February 19, 2016. During the nine months ended September 30, 2016, all of our subsidiary's outstanding advances, including accrued interest, were refinanced through repurchase agreements. During the nine months ended September 30, 2016, the Company redeemed all of its activity-based FHLBC stock but still holds stock with a carrying value of \$2,500, the minimum amount required to retain membership.

NOTE 4. DERIVATIVE FINANCIAL INSTRUMENTS

In connection with its interest rate risk management strategy, the Company economically hedges a portion of the cost of its repurchase agreement funding by entering into derivatives and other hedging contracts. To date, the Company has entered into Eurodollar and T-Note futures contracts, interest rate swaps, and interest rate swaptions, but may enter into other contracts in the future. The Company has not elected hedging treatment under GAAP, and as such all gains or losses (realized and unrealized) on these instruments are reflected in earnings for all periods presented.

In addition, the Company utilizes TBA securities as a means of investing in and financing Agency RMBS or as a means of reducing its exposure to Agency RMBS, and not as a hedge. The Company accounts for TBA securities as derivative instruments if either the TBA securities do not settle in the shortest period of time possible or if the Company cannot assert that it is probable at inception and throughout the term of the TBA securities that it will take physical delivery of the Agency RMBS for a long position, or make delivery of the Agency RMBS for a short position, upon settlement of the trade.

Derivative Assets (Liability), at Fair Value

The table below summarizes fair value information about our derivative assets and liabilities as of September 30, 2016 and December 31, 2015.

(in thousands)

Derivative Instruments and Related Accounts	Balance Sheet Location	September 30, 2016	December 31, 2015
Assets			
Interest rate swaps	Derivative assets, at fair value	\$ 1,097	\$ -
Receiver swaptions	Derivative assets, at fair value	-	669
Total derivative assets, at fair value		\$ 1,097	\$ 669
Liabilities			
Interest rate swaps	Derivative liabilities, at fair value	\$ 305	\$ -
TBA securities	Derivative liabilities, at fair value	240	-
Total derivative liabilities, at fair value		\$ 545	\$ -
Margin Balances Posted to Counterparties			
Futures contracts	Restricted cash	\$ 3,268	\$ 8,483
Interest rate swap contracts	Restricted cash	5,240	-
Total margin balances on derivative contracts		\$ 8,508	\$ 8,483

Eurodollar and T-Note futures are cash settled futures contracts on an interest rate, with gains and losses credited or charged to the Company's cash accounts on a daily basis. A minimum balance, or "margin", is required to be maintained in the account on a daily basis. The tables below present information related to the Company's Eurodollar and T-Note futures positions at September 30, 2016 and December 31, 2015.

(\$ in thousands)

Expiration Year	September 30, 2016				Open Equity ⁽¹⁾
	Average Contract Notional Amount	Weighted Average Entry Rate	Weighted Average Effective Rate	Weighted Average	
Eurodollar Futures Contracts (Short Positions)					
2016	\$200,000	1.79 %	0.92 %		\$(432)
2017	200,000	2.14 %	1.00 %		(2,279)
2018	200,000	2.53 %	1.14 %		(2,786)
2019	200,000	2.55 %	1.22 %		(665)
Total / Weighted Average	\$200,000	2.30 %	1.07 %		\$(6,162)
Treasury Note Futures Contracts (Short Position)⁽²⁾					
December 2016 10 year T-Note futures (Dec 2016 - Dec 2026 Hedge Period)	\$185,000	1.44 %	1.40 %		\$(335)

(\$ in thousands)

Expiration Year	December 31, 2015				
	Average Contract Notional Amount	Weighted Average Entry Rate	Weighted Average Effective Rate	Open Equity ⁽¹⁾	
Eurodollar Futures Contracts (Short Positions)					
2016	\$900,000	1.51	% 0.98	%	\$(4,718)
2017	900,000	2.31	% 1.59	%	(6,550)
2018	900,000	2.77	% 1.99	%	(7,060)
2019	900,000	2.56	% 2.17	%	(865)
Total / Weighted Average	\$900,000	2.23	% 1.57	%	\$(19,193)

Treasury Note Futures Contracts (Short Position)⁽²⁾

December 2015 10 year T-Note futures (Dec 2015 - Dec 2025 Hedge Period)	\$185,000	1.99	% 1.95	%	\$1,091
--	-----------	------	--------	---	---------

(1) Open equity represents the cumulative gains (losses) recorded on open futures positions from inception.

T-Note futures contracts were valued at a price of \$131.13 at September 30, 2016 and \$125.91 at December 31,

(2) 2015. The nominal values of the short positions was \$242.6 million and \$232.9 million at September 30, 2016 and December 31, 2015, respectively.

Under our interest rate swap agreements, we typically pay a fixed rate and receive a floating rate based on LIBOR ("payer swaps"). The floating rate we receive under our swap agreements has the effect of offsetting the repricing characteristics of our repurchase agreements and cash flows on such liabilities. We are typically required to post collateral on our interest rate swap agreements. The table below presents information related to the Company's interest rate swap positions at September 30, 2016.

(\$ in thousands)

Expiration	Notional Amount	Average Fixed Pay Rate	Net Average Receive Rate	Estimated Fair Value	Average Maturity (Years)

The table below presents information related to the Company's interest rate swaption positions at December 31, 2015.

(\$ in thousands)

Expiration	Option Cost	Weighted Average Fair Value	Weighted Average Months to Expiration	Underlying Swap		
				Fixed Receive Amount	Fixed Receive Rate (LIBOR)	Weighted Average Term (Years)
Receiver Swaptions						
≤ 1 year	\$1,100	\$669	4.2	\$100,000	1.77% 3 Month	5.0

Edgar Filing: Orchid Island Capital, Inc. - Form 10-Q

The following table summarizes our contracts to purchase and sell TBA securities as of September 30, 2016.

(\$ in thousands)

	Notional Amount	Cost	Market Value ⁽³⁾	Net Carrying Value ⁽⁴⁾
Long (Short) ⁽¹⁾		Basis ⁽²⁾		
30-Year TBA securities:				
4.0 %	\$(100,000)	\$(107,219)	\$(107,422)	\$(203)
4.5 %	(46,800)	(51,231)	(51,268)	(37)
	\$(146,800)	\$(158,450)	\$(158,690)	\$(240)

- (1) Notional amount represents the par value (or principal balance) of the underlying Agency RMBS.
- (2) Cost basis represents the forward price to be paid (received) for the underlying Agency RMBS.
- (3) Market value represents the current market value of the TBA securities (or of the underlying Agency RMBS) as of period-end.
- (4) Net carrying value represents the difference between the market value and the cost basis of the TBA securities as of period-end and is reported in derivative assets (liabilities), at fair value in our consolidated balance sheets.

Gain (Loss) From Derivative Instruments, Net

The table below presents the effect of the Company's derivative financial instruments on the consolidated statements of operations for the nine and three months ended September 30, 2016 and 2015.

(in thousands)

	Nine Months Ended		Three Months	
	September 30,		Ended September	
	2016	2015	2016	2015
Eurodollar futures contracts (short positions)	\$(17,507)	\$(26,406)	\$1,194	\$(15,446)
T-Note futures contracts (short position)	(12,288)	(8,061)	1,688	(7,050)
Interest rate swaps	(450)	-	4,179	-
Receiver swaptions	36	-	-	-
Payer swaptions	-	(1,217)	-	(65)
Net TBA securities	(2,385)	24	(474)	55
	\$(32,594)	\$(35,660)	\$6,587	\$(22,506)

Credit Risk-Related Contingent Features

The use of derivatives creates exposure to credit risk relating to potential losses that could be recognized in the event that the counterparties to these instruments fail to perform their obligations under the contracts. We minimize this risk by limiting our counterparties for instruments which are not centrally cleared on a registered exchange to major financial institutions with acceptable credit ratings and monitoring positions with individual counterparties. In addition, we may be required to pledge assets as collateral for our derivatives, whose amounts vary over time based on the market value, notional amount and remaining term of the derivative contract. In the event of a default by a

counterparty, we may not receive payments provided for under the terms of our derivative agreements, and may have difficulty obtaining our assets pledged as collateral for our derivatives. The cash and cash equivalents pledged as collateral for our derivative instruments are included in restricted cash on our consolidated balance sheets.

-15-

NOTE 5. PLEDGED ASSETS

Assets Pledged to Counterparties

The table below summarizes our assets pledged as collateral under our repurchase agreements, prime brokerage clearing accounts, FHLB advances, derivative agreements and insurance capital by type, including securities pledged related to securities sold but not yet settled, as of September 30, 2016 and December 31, 2015.

(in thousands)

Assets Pledged to Counterparties	September 30, 2016				Total
	Repurchase Agreements	Clearing Margin	Derivative Agreements	Insurance Capital ⁽¹⁾	
PT RMBS - fair value	\$2,356,027	\$ -	\$ -	\$ 1,235	\$2,357,262
Structured RMBS - fair value	66,539	8,491	-	-	75,030
Accrued interest on pledged securities	8,709	284	-	4	8,997
Restricted cash	8,123	-	8,508	250	16,881
Total	\$2,439,398	\$ 8,775	\$ 8,508	\$ 1,489	\$2,458,170

(in thousands)

Assets Pledged to Counterparties	December 31, 2015				Total
	Repurchase Agreements	FHLB Advances	Derivative Agreements	Insurance Capital ⁽¹⁾	
PT RMBS - fair value	\$1,833,020	\$191,550	\$ -	\$ 1,752	\$2,026,322
Structured RMBS - fair value	69,252	-	-	-	69,252
Accrued interest on pledged securities	7,019	645	-	6	7,670
Restricted cash	3,997	-	8,483	250	12,730
Total	\$1,913,288	\$192,195	\$ 8,483	\$ 2,008	\$2,115,974

(1) Orchid Island Casualty, Inc. is required to maintain sufficient capital in the form of cash and securities to protect it against losses.

Assets Pledged from Counterparties

The table below summarizes our assets pledged to us from counterparties under our repurchase agreements as of September 30, 2016 and December 31, 2015.

(in thousands)

Assets Pledged to Orchid	September 30, 2016	December 31, 2015
PT RMBS - fair value	\$ -	\$ 167
U.S. Treasury securities - fair value	201	723
Cash	217	1,421
Total	\$ 418	\$ 2,311

PT RMBS and U.S. Treasury securities received as margin under our repurchase agreements are not recorded in the consolidated balance sheets because the counterparty retains ownership of the security. Cash received as margin is recognized in cash and cash equivalents with a corresponding amount recognized as an increase in repurchase agreements in the consolidated balance sheets.

NOTE 6. OFFSETTING ASSETS AND LIABILITIES

The Company's derivatives and repurchase agreements are subject to underlying agreements with master netting or similar arrangements, which provide for the right of offset in the event of default or in the event of bankruptcy of either party to the transactions. The Company reports its assets and liabilities subject to these arrangements on a gross basis.

The following table presents information regarding those assets and liabilities subject to such arrangements as if the Company had presented them on a net basis as of September 30, 2016 and December 31, 2015.

(in thousands)

Offsetting of Assets

	Gross Amount of Recognized Assets	Gross Amount Offset in the Consolidated Balance Sheet	Net Amount Presented in the Consolidated Balance Sheet	Gross Amount Not Offset in the Consolidated Balance Sheet	Cash Received	Net Amount
				Instruments as Collateral	as Received	
September 30, 2016						
Interest rate swaps	\$ 1,097	\$ -	\$ 1,097	\$-	\$(1,097)	\$ -
December 31, 2015						
Receiver swaptions	\$ 669	\$ -	\$ 669	\$(669)	\$-	\$ -

(in thousands)

Offsetting of Liabilities

	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Consolidated Balance Sheet	Net Amount Presented in the Consolidated Balance Sheet	Gross Amount Not Offset in the Consolidated Balance Sheet	Instruments Posted as Collateral	Cash Posted	Net Amount
September 30, 2016							
Repurchase Agreements	\$2,298,097	\$ -	\$2,298,097	\$(2,289,974)		\$(8,123)	\$ -
Interest rate swaps	305	-	305	-		(305)	-
	\$2,298,402	\$ -	\$2,298,402	\$(2,289,974)		\$(8,428)	\$ -
December 31, 2015							
Repurchase Agreements	\$1,798,813	\$ -	\$1,798,813	\$(1,794,816)		\$(3,997)	\$ -

The amounts disclosed for collateral received by or posted to the same counterparty up to and not exceeding the net amount of the asset or liability presented in the consolidated balance sheets. The fair value of the actual collateral received by or posted to the same counterparty typically exceeds the amounts presented. See Notes 3 and 4 for a discussion of collateral posted or received against or for repurchase obligations and derivative instruments.

-17-

NOTE 7. CAPITAL STOCK

Common Stock Issuances

During 2016 and 2015, the Company completed the following public offerings of shares of its common stock. There were no common stock issuances through public offerings during the three months ended September 30, 2015, December 31, 2015 and March 31, 2016.

(\$ in thousands, except per share amounts)

Type of Offering	Period	Weighted Average Price Received Per Share ⁽¹⁾	Shares	Net Proceeds ⁽²⁾
2016				
At the Market Offering Program ⁽³⁾	Second Quarter	\$ 10.48	646,753	\$ 6,591
At the Market Offering Program ⁽³⁾	Third Quarter	10.80	3,818,802	40,525
			4,465,555	\$ 47,116
2015				
At the Market Offering Program ⁽³⁾	First Quarter	\$ 13.66	1,210,487	\$ 16,175
At the Market Offering Program ⁽³⁾	Second Quarter	13.65	5,024,530	67,100
			6,235,017	\$ 83,275

(1) Weighted average price received per share is gross of underwriters' discount, if applicable, and other offering costs.

(2) Net proceeds are net of the underwriters' discount, if applicable, and other offering costs.

(3) The Company has entered into four equity distribution agreements, three of which have been cancelled and replaced with the current agreement, to publicly offer and sell shares of the Company's common stock in at the market and privately negotiated transactions from time to time. As of September 30, 2016, shares with a value of \$87.4 million remain available for issuance under the July 2016 Equity Distribution Agreement.

Share Repurchase Program

On July 29, 2015, the Company's Board of Directors authorized the repurchase of up to 2,000,000 shares of the Company's common stock. As part of the share repurchase program, shares may be purchased in open market transactions, including through block purchases, through privately negotiated transactions, or pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Open market repurchases will be made in accordance with Exchange Act Rule 10b-18, which sets certain restrictions on the method, timing, price and volume of open market stock repurchases. The timing, manner, price and amount of any repurchases will be determined by the Company in its discretion and will be subject to economic and market conditions, stock price, applicable legal requirements and other factors. The authorization does not obligate the Company to acquire any particular amount of common stock and the program may be suspended or discontinued at the Company's discretion without prior notice.

From the inception of the share repurchase program through September 30, 2016, the Company repurchased a total of 1,216,243 shares at an aggregate cost of approximately \$10.8 million, including commissions and fees, for a weighted average price of \$8.92 per share. No shares have been repurchased during the nine months ended September 30, 2016.

Cash Dividends

The table below presents the cash dividends declared on the Company's common stock since its February 2013 IPO.

(in thousands, except per share amounts)

Year	Per Share Amount	Total
2013	\$ 1.395	\$4,662
2014	2.160	22,643
2015	1.920	38,748
2016 - YTD ⁽¹⁾	1.400	32,546
Totals	\$ 6.875	\$98,599

On October 12, 2016, the Company declared a dividend of \$0.14 per share to be paid on October 31, 2016. The (1)effect of this dividend is included in the table above but is not reflected in the Company's financial statements as of September 30, 2016.

NOTE 8. STOCK INCENTIVE PLAN

In October 2012, the Company's Board of Directors adopted and Bimini, then the Company's sole stockholder, approved, the Orchid Island Capital, Inc. 2012 Equity Incentive Plan (the "Incentive Plan") to recruit and retain employees, directors and other service providers, including employees of the Manager and other affiliates. The Incentive Plan provides for the award of stock options, stock appreciation rights, stock award, performance units, other equity-based awards (and dividend equivalents with respect to awards of performance units and other equity-based awards) and incentive awards. The Incentive Plan is administered by the Compensation Committee of the Company's Board of Directors except that the Company's full Board of Directors will administer awards made to directors who are not employees of the Company or its affiliates. The Incentive Plan provides for awards of up to an aggregate of 10% of the issued and outstanding shares of our common stock (on a fully diluted basis) at the time of the awards, subject to a maximum aggregate 4,000,000 shares of the Company's common stock that may be issued under the Incentive Plan.

Restricted Stock Awards

On April 25, 2014, the Compensation Committee granted each of our non-employee directors 6,000 shares of restricted common stock subject to a three year vesting schedule whereby 2,000 shares of the award vest on the first, second and third anniversaries of the award date. Directors will have all the rights of a stockholder with respect to the awards, including the right to receive dividends and vote the shares. The awards are subject to forfeiture should the director no longer be a member of the Board of Directors of the Company prior to the respective vesting dates.

Edgar Filing: Orchid Island Capital, Inc. - Form 10-Q

The table below presents information related to the Company's restricted common stock at September 30, 2016 and 2015.

(\$ in thousands, except per share data)

	Nine Months Ended September 30,			
	2016		2015	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Unvested, beginning of period	16,000	\$ 12.23	24,000	\$ 12.23
Granted	-	-	-	-
Vested and issued	(8,000)	12.23	(8,000)	12.23
Unvested, end of period	8,000	\$ 12.23	16,000	\$ 12.23
Compensation expense during period		\$ 73		\$ 73
Unrecognized compensation expense, end of period		\$ 57		\$ 155
Intrinsic value, end of period		\$ 83		\$ 148
Weighted-average remaining vesting term (in years)		0.6		1.6

Stock Awards

The Company issues immediately vested common stock under the Incentive Plan to certain executive officers, employees and directors. The following table presents information related to fully vested common stock issued during the nine months ended September 30, 2016 and 2015.

(\$ in thousands, except per share data)

	Nine Months Ended September 30,	
	2016	2015
Fully vested shares granted ⁽¹⁾	37,695	27,295
Weighted average grant date price	\$ 10.05	\$ 13.08
Compensation expense related to fully vested common share awards ⁽²⁾	\$ 379	\$ 357

The table above includes 33,019 shares of fully vested shares which were granted in January and March 2016 with (1) respect to service performed during 2015 and 21,715 shares of fully vested shares which were granted in January 2015 with respect to service performed during 2014.

Approximately \$330,000 of compensation expense related to the 2016 share awards were accrued and recognized (2) in 2015. Approximately \$288,000 of compensation expense related to the 2015 share awards were accrued and recognized in 2014.

Performance Units

The Company may issue performance units under the Incentive Plan to certain executive officers and employees. "Performance Units" vest after the end of a defined performance period, based on satisfaction of the performance conditions set forth in the performance unit agreement. When earned, each Performance Unit will be settled by the issuance of one share of the Company's common stock, at which time the Performance Unit will be cancelled. The

Performance Units contain dividend equivalent rights which entitle the Participants to receive distributions declared by the Company on common stock, but do not include the right to vote the shares. Performance Units are subject to forfeiture should the participant no longer serve as an executive officer or employee for the Company. Compensation expense for the Performance Units are recognized over the remaining vesting period once it becomes probable that the performance conditions will be achieved.

-20-

The following table presents information related to Performance Units outstanding during the nine months ended September 30, 2016.

(\$ in thousands, except per share data)

	Nine Months Ended September, 30,			
	2016		2015	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Unvested, beginning of period	7,508	\$ 13.32	-	\$ -
Granted	41,500	10.00	7,508	13.32
Forfeited	(100)	10.00	-	-
Vested and issued	(2,252)	13.32	-	-
Unvested, end of period	46,656	\$ 10.37	7,508	\$ 13.32
Compensation expense during period		\$ 148		\$ 34
Unrecognized compensation expense, end of period		\$ 320		\$ 66
Intrinsic value, end of period		\$ 486		\$ 69
Weighted-average remaining vesting term (in years)		1.6		1.6

NOTE 9. COMMITMENTS AND CONTINGENCIES

From time to time, the Company may become involved in various claims and legal actions arising in the ordinary course of business. Management is not aware of any reported or unreported contingencies at September 30, 2016.

NOTE 10. INCOME TAXES

The Company will generally not be subject to federal income tax on its REIT taxable income to the extent that it distributes its REIT taxable income to its stockholders and satisfies the ongoing REIT requirements, including meeting certain asset, income and stock ownership tests. A REIT must generally distribute at least 90% of its REIT taxable income to its stockholders, of which 85% generally must be distributed within the taxable year, in order to avoid the imposition of an excise tax. The remaining balance may be distributed up to the end of the following taxable year, provided the REIT elects to treat such amount as a prior year distribution and meets certain other requirements.

NOTE 11. EARNINGS PER SHARE (EPS)

The Company had dividend eligible shares of restricted common stock and Performance Units that were outstanding during the nine and three months ended September 30, 2016. The basic and diluted per share computations include these unvested shares of restricted common stock and performance units if there is income available to common stock, as they have dividend participation rights. The shares of restricted common stock and Performance Units have no contractual obligation to share in losses. Because there is no such obligation, the shares of restricted common stock and Performance Units are not included in the basic and diluted EPS computations when no income is available to common stock even though they are considered participating securities.

Edgar Filing: Orchid Island Capital, Inc. - Form 10-Q

The table below reconciles the numerator and denominator of EPS for the nine and three months ended September 30, 2016 and 2015.

(in thousands, except per-share information)

	Nine Months Ended September 30, 2016		Three Months Ended September 30, 2015	
Basic and diluted EPS per common share:				
Numerator for basic and diluted EPS per common share:				
Net income (loss) - Basic and diluted	\$22,397	\$(6,738)	\$20,526	\$(9,417)
Weighted average common shares:				
Common shares outstanding at the balance sheet date	26,252	21,893	26,252	21,893
Unvested dividend eligible share based compensation outstanding at the balance sheet date	55	-	55	-
Effect of weighting	(3,688)	(2,167)	(2,174)	652
Weighted average shares-basic and diluted	22,619	19,726	24,133	22,545
Net Income (loss) per common share:				
Basic and diluted	\$0.99	\$(0.34)	\$0.85	\$(0.42)

The average number of restricted common stock and Performance Units that were anti-dilutive and not included in diluted earnings per share for the nine and three months ended September 30, 2015 were 26,300 and 23,508, respectively.

NOTE 12. FAIR VALUE

Authoritative accounting literature establishes a framework for using fair value to measure assets and liabilities and defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) as opposed to the price that would be paid to acquire the asset or received to assume the liability (an entry price). A fair value measure should reflect the assumptions that market participants would use in pricing the asset or liability, including the assumptions about the risk inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset and the risk of non-performance. Required disclosures include stratification of balance sheet amounts measured at fair value based on inputs the Company uses to derive fair value measurements. These stratifications are:

Level 1 valuations, where the valuation is based on quoted market prices for identical assets or liabilities traded in active markets (which include exchanges and over-the-counter markets with sufficient volume),

Level 2 valuations, where the valuation is based on quoted market prices for similar instruments traded in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market, and

Level 3 valuations, where the valuation is generated from model-based techniques that use significant assumptions not observable in the market, but observable based on Company-specific data. These unobservable assumptions reflect the Company's own estimates for assumptions that market participants would use in pricing the asset or liability.

Valuation techniques typically include option pricing models, discounted cash flow models and similar techniques, but may also include the use of market prices of assets or liabilities that are not directly comparable to the subject asset or liability.

The Company's RMBS, interest rate swaptions and TBA securities are valued using Level 2 valuations, and such valuations currently are determined by the Company based on independent pricing sources and/or third party broker quotes, when available. Because the price estimates may vary, the Company must make certain judgments and

assumptions about the appropriate price to use to calculate the fair values. Alternatively, the Company could opt to have the value of all of our positions in RMBS, interest rate swaptions and TBA securities determined by either an independent third-party or do so internally.

-22-

RMBS (based on the fair value option), interest rate swaps, interest rate swaptions, TBA securities and futures contracts were recorded at fair value on a recurring basis during the nine and three months ended September 30, 2016 and 2015. When determining fair value measurements, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset. When possible, the Company looks to active and observable markets to price identical assets. When identical assets are not traded in active markets, the Company looks to market observable data for similar assets.

The following table presents financial assets (liabilities) measured at fair value on a recurring basis as of September 30, 2016 and December 31, 2015:

(in thousands)

	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2016				
Mortgage-backed securities	\$ 2,501,497	\$ -	\$2,501,497	\$ -
Margin posted on derivative agreements	8,508	8,508	-	-
Interest rate swaps	792	-	792	-
TBA securities	(240)	-	(240)	-
December 31, 2015				
Mortgage-backed securities	\$ 2,158,010	\$ -	\$2,158,010	\$ -
Margin posted on derivative agreements	8,483	8,483	-	-
Receiver swaptions	669	-	669	-

During the nine and three months ended September 30, 2016 and 2015, there were no transfers of financial assets or liabilities between levels 1, 2 or 3.

NOTE 13. RELATED PARTY TRANSACTIONS

Management Agreement

The Company is externally managed and advised by Bimini Advisors, LLC (the "Manager") pursuant to the terms of a management agreement. The management agreement has been renewed through February 20, 2017 and provides for automatic one-year extension options thereafter and is subject to certain termination rights. Under the terms of the management agreement, the Manager is responsible for administering the business activities and day-to-day operations of the Company. The Manager receives a monthly management fee in the amount of:

One-twelfth of 1.5% of the first \$250 million of the Company's equity, as defined in the management agreement,
 One-twelfth of 1.25% of the Company's equity that is greater than \$250 million and less than or equal to \$500 million,
 and
 One-twelfth of 1.00% of the Company's equity that is greater than \$500 million.

The Company is obligated to reimburse the Manager for any direct expenses incurred on its behalf and to pay the Manager the Company's pro rata portion of certain overhead costs set forth in the management agreement. Should the Company terminate the management agreement without cause, it will pay to the Manager a termination fee equal to three times the average annual management fee, as defined in the management agreement, before or on the last day of the term of the agreement.

-23-

Total expenses recorded for the management fee and costs incurred were approximately \$3.9 million and \$1.4 million for the nine and three months ended September 30, 2016, respectively, and \$3.7 million and \$1.3 million for the nine and three months ended September 30, 2015, respectively. At September 30, 2016 and December 31, 2015, the net amount due to affiliates was approximately \$0.5 million and \$0.5 million, respectively.

Other Relationships with Bimini

John B. Van Heuvelen, one of our independent directors, owns shares of common stock of Bimini. Robert Cauley, our Chief Executive Officer and Chairman of our Board of Directors, also serves as Chief Executive Officer and Chairman of the Board of Directors of Bimini and owns shares of common stock of Bimini. Hunter Haas, our Chief Financial Officer, Chief Investment Officer, Secretary and a member of our Board of Directors, also serves as the Chief Financial Officer, Chief Investment Officer and Treasurer of Bimini and owns shares of common stock of Bimini. In addition, as of September 30, 2016, Bimini owned 1,395,036 shares, or 5.3%, of the Company's common stock.

-24-

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and notes to those statements included in Item 1 of this Form 10-Q. The discussion may contain certain forward-looking statements that involve risks and uncertainties. Forward-looking statements are those that are not historical in nature. As a result of many factors, such as those set forth under "Risk Factors" in our most recent Annual Report on Form 10-K, our actual results may differ materially from those anticipated in such forward-looking statements.

Overview

We are a specialty finance company that invests in residential mortgage-backed securities ("RMBS") which are issued and guaranteed by a federally chartered corporation or agency ("Agency RMBS"). Our investment strategy focuses on, and our portfolio consists of, two categories of Agency RMBS: (i) traditional pass-through Agency RMBS ("PT RMBS") and (ii) structured Agency RMBS, such as collateralized mortgage obligations ("CMOs"), interest only securities ("IOs"), inverse interest only securities ("IIOs") and principal only securities ("POs"), among other types of structured Agency RMBS. We were formed by Bimini in August 2010, commenced operations on November 24, 2010 and completed our initial public offering ("IPO") on February 20, 2013. We are externally managed by Bimini Advisors, a registered investment adviser with the Securities and Exchange Commission (the "SEC").

Our business objective is to provide attractive risk-adjusted total returns over the long term through a combination of capital appreciation and the payment of regular monthly distributions. We intend to achieve this objective by investing in and strategically allocating capital between the two categories of Agency RMBS described above. We seek to generate income from (i) the net interest margin on our leveraged pass-through Agency RMBS portfolio and the leveraged portion of our structured Agency RMBS portfolio, and (ii) the interest income we generate from the unleveraged portion of our structured Agency RMBS portfolio. We intend to fund our pass-through Agency RMBS and certain of our structured Agency RMBS through short-term borrowings structured as repurchase agreements. Pass-through Agency RMBS and structured Agency RMBS typically exhibit materially different sensitivities to movements in interest rates. Declines in the value of one portfolio may be offset by appreciation in the other. The percentage of capital that we allocate to our two Agency RMBS asset categories will vary and will be actively managed in an effort to maintain the level of income generated by the combined portfolios, the stability of that income stream and the stability of the value of the combined portfolios. We believe that this strategy will enhance our liquidity, earnings, book value stability and asset selection opportunities in various interest rate environments.

We operate so as to qualify to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Code"). We generally will not be subject to U.S. federal income tax to the extent that we currently distribute all of our REIT taxable income (as defined in the Code) to our stockholders and maintain our REIT qualification.

The Company's common stock trades on the New York Stock Exchange ("NYSE") under the symbol "ORC".

Capital Raising Activities

We completed secondary offerings in January and March 2014, raising aggregate net proceeds of approximately \$68.2 million from the sale of 5,750,000 shares of our common stock inclusive of the \$5.7 million of net proceeds received from the exercise of the underwriters' overallotment option granted in the March 2014 offering, which closed in April 2014.

On June 17, 2014, we entered into an equity distribution agreement (the "June 2014 Equity Distribution Agreement") with two sales agents pursuant to which we could offer and sell, from time to time, up to an aggregate amount of

\$35,000,000 of shares of our common stock in transactions that were deemed to be "at the market" offerings and privately negotiated transactions. We issued a total of 2,528,416 shares under the June 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$34.2 million, net of commissions and fees, prior to its termination.

-25-

On September 3, 2014, we entered into a second equity distribution agreement (the "September 2014 Equity Distribution Agreement") with two sales agents pursuant to which we could offer and sell, from time to time, up to an aggregate amount of \$75,000,000 of shares of our common stock in transactions that were deemed to be "at the market" offerings and privately negotiated transactions. The September 2014 Equity Distribution Agreement replaced the June 2014 Equity Distribution Agreement. We issued a total of 5,087,646 shares under the September 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$69.1 million, net of commissions and fees, prior to its termination.

On March 2, 2015, we entered into a third equity distribution agreement (the "March 2015 Equity Distribution Agreement") with two sales agents pursuant to which we may offer and sell, from time to time, up to an aggregate amount of \$100,000,000 of shares of our common stock in transactions that are deemed to be "at the market" offerings and privately negotiated transactions. The March 2015 Equity Distribution Agreement replaced the September 2014 Equity Distribution Agreement. We issued a total of 7,218,766 shares under the March 2015 Equity Distribution Agreement for aggregate proceeds of approximately \$93.2 million, net of commissions and fees, prior to its termination.

On July 29, 2015, the Company's Board of Directors authorized the repurchase of up to 2,000,000 shares of our common stock. The timing, manner, price and amount of any repurchases will be determined by the Company in its discretion and will be subject to economic and market conditions, stock price, applicable legal requirements and other factors. The authorization does not obligate the Company to acquire any particular amount of common stock and the program may be suspended or discontinued at the Company's discretion without prior notice. From the inception of the share repurchase program through September 30, 2016, we repurchased a total of 1,216,243 shares at an aggregate cost of approximately \$10.8 million, including commissions and fees, for a weighted average price of \$8.92 per share.

On July 29, 2016, we entered into a fourth equity distribution agreement (the "July 2016 Equity Distribution Agreement") with two sales agents pursuant to which we may offer and sell, from time to time, up to an aggregate amount of \$125,000,000 of shares of our common stock in transactions that are deemed to be "at the market" offerings and privately negotiated transactions. The July 2016 Equity Distribution Agreement replaced the March 2015 Equity Distribution Agreement. Through September 30, 2016, we had issued a total of 3,467,891 shares under the July 2016 Equity Distribution Agreement for aggregate proceeds of approximately \$37.0 million, net of commissions and fees.

Factors that Affect our Results of Operations and Financial Condition

A variety of industry and economic factors may impact our results of operations and financial condition. These factors include:

- interest rate trends;
- the difference between Agency RMBS yields and our funding and hedging costs;
- competition for investments in Agency RMBS;
- recent actions taken by the Federal Reserve and the U.S. Treasury;
- prepayment rates on mortgages underlying our Agency RMBS, and credit trends insofar as they affect prepayment rates; and
- other market developments.

In addition, a variety of factors relating to our business may also impact our results of operations and financial condition. These factors include:

- our degree of leverage;
- our access to funding and borrowing capacity;
- our borrowing costs;
- our hedging activities;

the market value of our investments; and
the requirements to qualify as a REIT and the requirements to qualify for a registration exemption under the
Investment Company Act.

-26-

Results of Operations

Described below are the Company's results of operations for the nine and three months ended September 30, 2016, as compared to the Company's results of operations for the nine and three months ended September 30, 2015.

Net Income (Loss) Summary

Net income for the nine months ended September 30, 2016 was \$22.4 million, or \$0.99 per share. Net loss for the nine months ended September 30, 2015 was \$6.7 million, or \$0.34 per share. Net income for the three months ended September 30, 2016 was \$20.5 million, or \$0.85 per share. Net loss for the three months ended September 30, 2015 was \$9.4 million, or \$0.42 per share. The components of net income (loss) for the nine and three months ended September 30, 2016 and 2015, along with the changes in those components are presented in the table below:

(in thousands)

	Nine Months Ended September 30,			Three Months Ended, September 30,		
	2016	2015	Change	2016	2015	Change
Interest income	\$62,059	\$49,719	\$12,340	\$22,358	\$18,352	\$4,006
Interest expense	(10,629)	(4,900)	(5,729)	(3,979)	(2,037)	(1,942)
Net interest income	51,430	44,819	6,611	18,379	16,315	2,064
Losses on RMBS and derivative contracts	(22,446)	(45,762)	23,316	4,418	(23,682)	28,100
Net portfolio income (loss)	28,984	(943)	29,927	22,797	(7,367)	30,164
Expenses	(6,587)	(5,795)	(792)	(2,271)	(2,050)	(221)
Net income (loss)	\$22,397	\$(6,738)	\$29,135	\$20,526	\$(9,417)	\$29,943

GAAP and Non-GAAP Reconciliations

In addition to the results presented in accordance with GAAP, our results of operations discussed below include certain non-GAAP financial information, including "Economic Interest Expense" and "Economic Net Interest Income."

Economic Interest Expense and Economic Net Interest Income

We use derivative instruments, specifically Eurodollar and Treasury Note ("T-Note") futures contracts, interest rate swaps and swaptions, to hedge a portion of the interest rate risk on repurchase agreements in a rising rate environment. As discussed above, we have not elected to designate our derivative holdings for hedge accounting treatment. Therefore, changes in fair value of these instruments are presented in a separate line item in our consolidated statements of operations and not included in interest expense.

We have not elected to designate our derivative holdings for hedge accounting treatment under the Financial Accounting Standards Board, (the "FASB"), Accounting Standards Codification, ("ASC"), Topic 815, Derivatives and Hedging. Changes in fair value of these instruments are presented in a separate line item in our consolidated statements of operations and not included in interest expense. As such, for financial reporting purposes, interest expense and cost of funds are not impacted by the fluctuation in value of the derivative instruments.

For the purpose of computing economic net interest income and ratios relating to cost of funds measures, GAAP interest expense has been adjusted to reflect the realized gains or losses on specific derivative instruments that pertain to each period presented. Interest expense, including the effect of derivative instruments for the period, is referred to as economic interest expense. Net interest income, when calculated to include the effect of derivative instruments for the period, is referred to as economic net interest income.

We believe that economic interest expense and economic net interest income provides meaningful information to consider, in addition to the respective amounts prepared in accordance with GAAP. The non-GAAP measures help management to evaluate its financial position and performance without the effects of certain transactions and GAAP adjustments that are not necessarily indicative of its current investment portfolio or operations. The unrealized gains or losses on derivative instruments presented in our consolidated statements of operations are not necessarily representative of the total interest rate expense that we will ultimately realize. This is because as interest rates move up or down in the future, the gains or losses we ultimately realize, and which will affect our total interest rate expense in future periods, may differ from the unrealized gains or losses recognized as of the reporting date.

Our presentation of the economic value of its hedging strategy has important limitations. First, other market participants may calculate economic interest expense and economic net interest income differently than the way we calculate them. Second, while we believe that the calculation of the economic value of our hedging strategy described above helps to present our financial position and performance, it may be of limited usefulness as an analytical tool. Therefore, the economic value of our investment strategy should not be viewed in isolation and is not a substitute for interest expense and net interest income computed in accordance with GAAP.

The tables below present a reconciliation of the adjustments to interest expense shown for each period relative to our derivative instruments, and the income statement line item, gains (losses) on derivative instruments, calculated in accordance with GAAP for the nine months ended September 30, 2016 and 2015 and each quarter during 2016 and 2015.

Gains (Losses) on Derivative Instruments
(in thousands)

	Recognized		Funding Hedges	
	in		to	Attributed to
	Income	TBA	Current	Future
	Statement	Securities	Period	Periods
	(GAAP)	Income	(Non-GAAP)	(Non-GAAP)
Three Months Ended				
September 30, 2016	\$ 6,587	\$ (474)	\$ (2,660)	\$ 9,721
June 30, 2016	(11,591)	(786)	(2,210)	(8,595)
March 31, 2016	(27,590)	(1,125)	(1,933)	(24,532)
December 31, 2015	12,770	362	(1,196)	13,604
September 30, 2015	(22,506)	55	(881)	(21,680)
June 30, 2015	(803)	(88)	(595)	(120)
March 31, 2015	(12,351)	57	(306)	(12,102)
Nine Months Ended				
September 30, 2016	\$ (32,594)	\$ (2,385)	\$ (6,803)	\$ (23,406)
September 30, 2015	(35,660)	24	(1,782)	(33,902)

Economic Interest Expense and Economic Net Interest Income
(in thousands)

	Interest Expense on Borrowings			Economic Interest Expense ⁽²⁾	Net Interest Income	
	GAAP Interest Expense	GAAP Interest Expense	Gains (Losses) on Derivative Instruments to Current Period ⁽¹⁾		GAAP Net Interest Income	Economic Net Interest Income ⁽³⁾
Three Months Ended						
September 30, 2016	\$22,358	\$3,979	\$ (2,660)	\$ 6,639	\$18,379	\$ 15,719
June 30, 2016	19,235	3,330	(2,210)	5,540	15,905	13,695
March 31, 2016	20,466	3,319	(1,933)	5,252	17,147	15,214
December 31, 2015	19,092	2,371	(1,196)	3,567	16,721	15,525
September 30, 2015	18,352	2,037	(881)	2,918	16,315	15,434
June 30, 2015	16,753	1,567	(595)	2,162	15,186	14,591
March 31, 2015	14,614	1,296	(306)	1,602	13,318	13,012
Nine Months Ended						
September 30, 2016	\$62,059	\$10,629	\$ (6,803)	\$ 17,431	\$51,430	44,628
September 30, 2015	49,719	4,900	(1,782)	6,682	44,819	43,037

(1) Reflects the effect of derivative instrument hedges for only the period presented.

(2) Calculated by adding the effect of derivative instrument hedges attributed to the period presented to GAAP interest expense.

(3) Calculated by adding the effect of derivative instrument hedges attributed to the period presented to GAAP net interest income.

Net Interest Income

During the nine months ended September 30, 2016, we generated \$51.4 million of net interest income, consisting of \$62.1 million of interest income from RMBS assets offset by \$10.6 million of interest expense on borrowings. For the comparable period ended September 30, 2015, we generated \$44.8 million of net interest income, consisting of \$49.7 million of interest income from RMBS assets offset by \$4.9 million of interest expense on borrowings. The \$12.3 million increase in interest income and \$5.7 million increase in interest expense for the nine months ended September 30, 2016 reflects the growth of our portfolio fueled by our capital raising activities during the first six months of 2015 and the second and third quarters of 2016, as well as increased yields earned on our portfolio and increased costs of borrowings.

On an economic basis, our interest expense on borrowings for the nine months ended September 30, 2016 and 2015 was \$17.4 million and \$6.7 million, respectively, resulting in \$44.6 million and \$43.0 million of economic net interest income, respectively.

During the three months ended September 30, 2016, we generated \$18.4 million of net interest income, consisting of \$22.4 million of interest income from RMBS assets offset by \$4.0 million of interest expense on borrowings. For the three months ended September 30, 2015, we generated \$16.3 million of net interest income, consisting of \$18.4 million of interest income from RMBS assets offset by \$2.0 million of interest expense on borrowings. As in the year to date period, the increased interest income and interest expense for the three months ended September 30, 2016 as compared to the same period in 2015, reflects a combination of the growth of our portfolio and increased yields on the portfolio and costs of borrowings.

On an economic basis, our interest expense on repurchase liabilities for the three months ended September 30, 2016 and 2015 was \$6.6 million and \$2.9 million, respectively, resulting in \$15.7 million and \$15.4 million of economic net interest income, respectively.

-29-

Edgar Filing: Orchid Island Capital, Inc. - Form 10-Q

The tables below provide information on our portfolio average balances, interest income, yield on assets, average borrowings, interest expense, cost of funds, net interest income and net interest spread for the nine months ended September 30, 2016 and 2015 and each quarter during 2016 and 2015 on both a GAAP and economic basis.

(\$ in thousands)

	Average		Yield on		Interest Expense		Average Cost of Funds			
	RMBS Held ⁽¹⁾	Interest Income	Average RMBS	Average Borrowings ⁽¹⁾	GAAP Basis	Economic Basis ⁽²⁾	GAAP Basis	Economic Basis ⁽³⁾		
Three Months Ended										
September 30, 2016	\$2,362,377	\$22,358	3.79	% \$ 2,179,462	\$3,979	\$ 6,639	0.73%	1.22	%	
June 30, 2016	2,100,151	19,235	3.66	% 2,000,158	3,330	5,540	0.67%	1.11	%	
March 31, 2016	2,067,527	20,466	3.96	% 1,962,901	3,319	5,252	0.68%	1.07	%	
December 31, 2015	2,137,810	19,092	3.57	% 1,964,806	2,371	3,567	0.48%	0.73	%	
September 30, 2015	2,146,240	18,352	3.42	% 1,978,685	2,037	2,918	0.41%	0.59	%	
June 30, 2015	1,925,746	16,753	3.48	% 1,736,781	1,567	2,162	0.36%	0.50	%	
March 31, 2015	1,612,896	14,614	3.62	% 1,448,071	1,296	1,602	0.36%	0.44	%	
Nine Months Ended										
September 30, 2016	\$2,176,685	\$62,059	3.80	% \$ 2,047,507	\$10,628	\$ 17,431	0.69%	1.14	%	
September 30, 2015	1,894,961	49,719	3.50	% 1,721,179	4,900	6,682	0.38%	0.52	%	

(\$ in thousands)

	Net Interest Income		Net Interest Spread		
	GAAP Basis	Economic Basis ⁽²⁾	GAAP Basis	Economic Basis ⁽⁴⁾	
Three Months Ended					
September 30, 2016	\$18,379	\$ 15,719	3.06%	2.57	%
June 30, 2016	15,905	13,695	2.99%	2.55	%
March 31, 2016	17,147	15,214	3.28%	2.89	%
December 31, 2015	16,721	15,525	3.09%	2.84	%
September 30, 2015	16,315	15,434	3.01%	2.83	%
June 30, 2015	15,186	14,591	3.12%	2.98	%
March 31, 2015	13,318	13,012	3.26%	3.18	%
Nine Months Ended					
September 30, 2016	\$51,430	\$ 44,628	3.11%	2.66	%
September 30, 2015	44,819	43,037	3.12%	2.98	%

Portfolio yields and costs of borrowings presented in the tables above and the tables on pages 31 and 32 are calculated based on the average balances of the underlying investment portfolio/borrowings balances and are annualized for the periods presented. Average balances for quarterly periods are calculated using two data points, the beginning and ending balances.

(2) Economic interest expense and economic net interest income presented in the table above and the tables on page 32 includes the effect of our derivative instrument hedges for only the periods presented.

(3) Represents interest cost of our borrowings and the effect of derivative instrument hedges attributed to the period divided by Average RMBS.

(4) Economic net interest spread is calculated by subtracting average economic cost of funds from realized yield on average RMBS.

Interest Income and Average Asset Yield

Our interest income for the nine months ended September 30, 2016 and 2015 was \$62.1 million and \$49.7 million, respectively. We had average RMBS holdings of \$2,176.7 million and \$1,895.0 million for the nine months ended September 30, 2016 and 2015, respectively. The yield on our portfolio was 3.80% and 3.50% for the nine months ended September 30, 2016 and 2015, respectively. For the nine months ended September 30, 2016 as compared to the nine months ended September 30, 2015, there was a \$12.3 million increase in interest income due to a \$281.7 million increase in average RMBS, combined with a 30 basis point ("bps") increase in the yield on average RMBS. The increase in average RMBS during the nine months ended September 30, 2016 reflects the deployment of the proceeds of our capital raising activities, on a leveraged basis.

Our interest income for the three months ended September 30, 2016 and 2015 was \$22.4 million and \$18.4 million, respectively. We had average RMBS holdings of \$2,362.4 million and \$2,146.2 million for the three months ended September 30, 2016 and 2015, respectively. The yield on our portfolio was 3.79% and 3.42% for the three months ended September 30, 2016 and 2015, respectively. For the three months ended September 30, 2016 as compared to the three months ended September 30, 2015, there was a \$4.0 million increase in interest income due to a \$216.1 million increase in average RMBS, combined with a 37 bps increase in the yield on average RMBS. The increase in average RMBS during the three months ended September 30, 2016, as compared to the three months ended September 30, 2015, reflects the deployment of the proceeds of our capital raising activities after September 30, 2015, and before July 1, 2016, on a leveraged basis.

The table below presents the average portfolio size, income and yields of our respective sub-portfolios, consisting of structured RMBS and pass-through RMBS ("PT RMBS") for the nine months ended September 30, 2016 and 2015 and each quarter during 2016 and 2015.

(\$ in thousands)

	Average RMBS Held			Interest Income			Realized Yield on Average RMBS		
	PT RMBS	Structured RMBS	Total	PT RMBS	Structured RMBS	Total	PT RMBS	Structured RMBS	Total
Three Months Ended									
September 30, 2016	\$2,257,480	\$104,897	\$2,362,377	\$21,898	\$460	\$22,358	3.88%	1.75%	3.79%
June 30, 2016	2,006,392	93,759	2,100,151	19,072	163	19,235	3.80%	0.70%	3.66%
March 31, 2016	1,968,690	98,837	2,067,527	19,682	784	20,466	4.00%	3.17%	3.96%
December 31, 2015	2,034,623	103,187	2,137,810	19,337	(245)	19,092	3.80%	(0.95)%	3.57%
September 30, 2015	2,033,494	112,746	2,146,240	18,642	(290)	18,352	3.67%	(1.03)%	3.42%
June 30, 2015	1,824,893	100,853	1,925,746	16,549	204	16,753	3.63%	0.81%	3.48%
March 31, 2015	1,541,497	71,399	1,612,896	14,629	(15)	14,614	3.80%	(0.09)%	3.62%
Nine Months Ended									
September 30, 2016	\$2,077,521	\$99,164	\$2,176,685	\$60,652	\$1,407	\$62,059	3.89%	1.89%	3.80%
September 30, 2015	1,799,962	94,999	1,894,961	49,820	(101)	49,719	3.69%	(0.14)%	3.50%

Interest Expense and the Cost of Funds

We had average borrowings of \$2,047.5 million and \$1,721.2 million and total interest expense of \$10.6 million and \$4.9 million for the nine months ended September 30, 2016 and 2015, respectively. Our average cost of funds was 0.69% for the nine months ended September 30, 2016, compared to 0.38% for the comparable period in 2015. There was a \$326.3 million increase in average outstanding borrowings during the nine months ended September 30, 2016 as compared to the nine months ended September 30, 2015. The higher cost of funds for the nine months ended September 30, 2016, compared to the same period in 2015, reflects the higher short-term rates as presented in the table below. The increase in average outstanding borrowings reflects the leveraging of the proceeds of our capital raising activities.

Our economic interest expense was \$17.4 million and \$6.7 million for the nine months ended September 30, 2016 and 2015, respectively. There was a 62 bps increase in the average economic cost of funds to 1.14% for the nine months ended September 30, 2016 from 0.52% for the nine months ended September 30, 2015. The increase in economic interest expense was partially due to the increase in average outstanding borrowings during the nine months ended September 30, 2016, combined with losses on derivative agreements attributed to the current period.

We had average outstanding borrowings of \$2,179.5 million and \$1,978.7 million and total interest expense of \$4.0 million and \$2.0 million for the three months ended September 30, 2016 and 2015, respectively. Our average cost of funds was 0.73% and 0.41% for three months ended September 30, 2016 and 2015, respectively. There was a 32 bps increase in the average cost of funds and a \$200.8 million increase in average outstanding borrowings during the three months ended September 30, 2016 as compared to the three months ended September 30, 2015. As in the year to date period, the higher cost of funds for the three months ended September 30, 2016, compared to the same period in 2015, reflects higher short-term rates, and the increase in average outstanding borrowings reflects the leveraging of the proceeds of our capital raising activities.

Our economic interest expense was \$6.6 million and \$2.9 million for the three months ended September 30, 2016 and 2015, respectively. There was a 63 bps increase in the average economic cost of funds to 1.22% for the three months ended September 30, 2016 from 0.59% for the three months ended September 30, 2015. The increase in economic interest expense during the three months ended September 30, 2016 was due to a combination of the increase in average outstanding borrowings, higher average interest rates charged for those borrowings, and losses on derivative agreements attributed to the current period.

Since all of our repurchase agreements are short-term, changes in market rates directly affect our interest expense. Our average cost of funds calculated on a GAAP basis was 24 bps above the average one-month LIBOR and 36 bps below the average six-month LIBOR for the quarter ended September 30, 2016. Our average economic cost of funds was 73 bps above the average one-month LIBOR and 13 bps above the average six-month LIBOR for the quarter ended September 30, 2016. The average term to maturity of the outstanding repurchase agreements decreased to 13 days at September 30, 2016 from 15 days at December 31, 2015.

The tables below presents the average balance of repurchase agreements outstanding, interest expense and average cost of funds, and average one-month and six-month LIBOR rates for the nine months ended September 30, 2016 and 2015 and each quarter in 2016 and 2015 on both a GAAP and economic basis.

(\$ in thousands)

	Average Balance of Borrowings	Interest Expense		Average Cost of Funds		
		GAAP Basis	Economic Basis	GAAP Basis	Economic Basis	
Three Months Ended						
September 30, 2016	\$2,179,462	\$3,979	\$6,639	0.73%	1.22%	%
June 30, 2016	2,000,158	3,330	5,540	0.67%	1.11%	%
March 31, 2016	1,962,901	3,319	5,252	0.68%	1.07%	%
December 31, 2015	1,964,806	2,371	3,567	0.48%	0.73%	%
September 30, 2015	1,978,685	2,037	2,918	0.41%	0.59%	%
June 30, 2015	1,736,781	1,567	2,162	0.36%	0.50%	%
March 31, 2015	1,448,071	1,296	1,602	0.36%	0.44%	%
Nine Months Ended						
September 30, 2016	\$2,047,507	\$10,628	\$17,431	0.69%	1.14%	%
September 30, 2015	1,721,179	4,900	6,682	0.38%	0.52%	%

	Average LIBOR		Average GAAP Cost of Funds Relative to Average		Average Economic Cost of Funds Relative to Average	
	One-Month	Six-Month	One-Month LIBOR	Six-Month LIBOR	One-Month LIBOR	Six-Month LIBOR
Three Months Ended						
September 30, 2016	0.49%	1.09%	0.24%	(0.36)%	0.73%	0.13%
June 30, 2016	0.44%	0.92%	0.23%	(0.25)%	0.67%	0.19%
March 31, 2016	0.40%	0.84%	0.28%	(0.16)%	0.67%	0.23%
December 31, 2015	0.28%	0.65%	0.20%	(0.17)%	0.45%	0.08%
September 30, 2015	0.19%	0.49%	0.22%	(0.08)%	0.40%	0.10%
June 30, 2015	0.18%	0.40%	0.18%	(0.04)%	0.32%	0.10%
March 31, 2015	0.17%	0.35%	0.19%	0.01%	0.27%	0.09%
Nine Months Ended						
September 30, 2016	0.44%	0.95%	0.25%	(0.26)%	0.70%	0.19%
September 30, 2015	0.18%	0.41%	0.20%	(0.03)%	0.34%	0.11%

Gains or Losses

The table below presents our gains or losses for the nine and three months ended September 30, 2016 and 2015.

(in thousands)

	Nine Months Ended			Three Months Ended		
	September 30, 2016	September 30, 2015	Change	September 30, 2016	September 30, 2015	Change
Realized gains (losses) on sales of RMBS	\$4,482	\$(1,073)	\$5,555	\$229	\$850	\$(621)
Unrealized gains (losses) on RMBS	5,652	(9,029)	14,681	(2,398)	(2,026)	(372)
Total gains (losses) on RMBS	10,134	(10,102)	20,236	(2,169)	(1,176)	(993)
Losses on interest rate futures	(29,795)	(34,467)	4,672	2,882	(22,496)	25,378
Losses on interest rate swaps	(450)	-	(450)	4,179	-	4,179
Gains (losses) on payer swaptions	36	(1,217)	1,253	-	(65)	65
(Losses) gains on TBA securities	(2,385)	24	(2,409)	(474)	55	(529)

We invest in RMBS with the intent to earn net income from the realized yield on those assets over their related funding and hedging costs, and not for purposes of making short term gains from sales. However, we have sold, and may continue to sell, existing assets to acquire new assets, which our management believes might have higher risk-adjusted returns in light of current or anticipated interest rates, federal government programs or general economic conditions or to manage our balance sheet as part of our asset/liability management strategy. During the nine months ended September 30, 2016 and 2015, we received proceeds of \$1,717.6 million and \$1,364.8 million, respectively, from the sales of RMBS. During the three months ended September 30, 2016 and 2015, we received proceeds of \$418.2 million and \$962.2 million, respectively, from the sales of RMBS, including sales settling in subsequent periods.

Realized and unrealized gains and losses on RMBS are driven in part by changes in yields and interest rates, which affect the pricing of the securities in our portfolio. Gains and losses on interest rate futures contracts are affected by changes in implied forward rates during the reporting period. The table below presents historical interest rate data for each quarter end during 2016 and 2015.

	5 Year Treasury Rate ⁽¹⁾	10 Year Treasury Rate ⁽¹⁾	15 Year Fixed-Rate Mortgage Rate ⁽²⁾	30 Year Fixed-Rate Mortgage Rate ⁽²⁾	Three Month LIBOR ⁽³⁾
September 30, 2016	1.16%	1.61%	2.76%	3.46%	0.85%
June 30, 2016	1.01%	1.49%	2.84%	3.57%	0.65%
March 31, 2016	1.22%	1.79%	2.97%	3.69%	0.63%
December 31, 2015	1.76%	2.27%	3.21%	3.96%	0.54%
September 30, 2015	1.38%	2.06%	3.10%	3.89%	0.33%
June 30, 2015	1.63%	2.34%	3.19%	3.98%	0.28%
March 31, 2015	1.38%	1.93%	3.04%	3.77%	0.27%

(1) Historical 5 and 10 Year Treasury Rates are obtained from quoted end of day prices on the Chicago Board Options Exchange.

(2) Historical 30 Year and 15 Year Fixed Rate Mortgage Rates are obtained from Freddie Mac's Primary Mortgage Market Survey.

(3) Historical LIBOR are obtained from the Intercontinental Exchange Benchmark Administration Ltd.

Expenses

For the nine and three months ended September 30, 2016, the Company's total operating expenses were approximately \$6.6 million and \$2.3 million, respectively, compared to approximately \$5.8 million and \$2.1 million, respectively, for the nine and three months ended September 30, 2015. The table below presents a breakdown of operating expenses for the nine and three months ended September 30, 2016 and 2015.

(in thousands)

	Nine Months Ended September 30,			Three Months Ended September 30,		
	2016	2015	Change	2016	2015	Change
Management fees	\$2,968	\$2,929	\$ 39	\$1,052	\$1,061	\$ (9)
Overhead allocation	963	774	189	336	260	76
Accrued incentive compensation	598	484	114	212	162	50
Directors fees and liability insurance	763	732	31	236	250	(14)
Audit, legal and other professional fees	654	493	161	193	160	33
Other direct REIT operating expenses	426	174	252	187	86	101
Other expenses	215	209	6	55	71	(16)
Total expenses	\$6,587	\$5,795	\$ 792	\$2,271	\$2,050	\$ 221

The Company is externally managed and advised by Bimini Advisors, LLC (the "Manager") pursuant to the terms of a management agreement. The management agreement has been renewed through February 20, 2017 and provides for automatic one-year extension options thereafter and is subject to certain termination rights. Under the terms of the management agreement, the Manager is responsible for administering the business activities and day-to-day operations of the Company. The Manager receives a monthly management fee in the amount of:

One-twelfth of 1.5% of the first \$250 million of the Company's equity, as defined in the management agreement,
 One-twelfth of 1.25% of the Company's equity that is greater than \$250 million and less than or equal to \$500 million,
 and

One-twelfth of 1.00% of the Company's equity that is greater than \$500 million.

The Company is obligated to reimburse the Manager for any direct expenses incurred on its behalf and to pay the Manager the Company's pro rata portion of certain overhead costs set forth in the management agreement. Should the Company terminate the management agreement without cause, it will pay to the Manager a termination fee equal to three times the average annual management fee, as defined in the management agreement, before or on the last day of term of the agreement.

Financial Condition:

Mortgage-Backed Securities

As of September 30, 2016, our RMBS portfolio consisted of \$2,501.5 million of Agency RMBS at fair value and had a weighted average coupon on assets of 4.22%. During the nine months ended September 30, 2016, we received principal repayments of \$178.5 million compared to \$166.9 million for the nine months ended September 30, 2015. The average prepayment speeds for the quarters ended September 30, 2016 and 2015 were 11.7% and 10.2%, respectively.

The following table presents the constant prepayment rate ("CPR") experienced on our structured and PT RMBS sub-portfolios, on an annualized basis, for the quarterly periods presented. CPR is a method of expressing the prepayment rate for a mortgage pool that assumes that a constant fraction of the remaining principal is prepaid each month or year. Specifically, the CPR in the chart below represents the three month prepayment rate of the securities in the respective asset category. Assets that were not owned for the entire quarter have been excluded from the calculation. The exclusion of certain assets during periods of high trading activity can create a very high, and often volatile, reliance on a small sample of underlying loans.

	PT RMBS	Structured RMBS	Total
Three Months Ended	Portfolio (%)	Portfolio (%)	Portfolio (%)
September 30, 2016	8.9	17.9	11.7
June 30, 2016	8.4	15.9	11.0
March 31, 2016	5.5	12.4	8.2
December 31, 2015	6.8	13.4	9.0
September 30, 2015	6.1	16.2	10.2
June 30, 2015	13.8	17.9	15.3
March 31, 2015	8.1	14.6	9.7

Edgar Filing: Orchid Island Capital, Inc. - Form 10-Q

The following tables summarize certain characteristics of the Company's PT RMBS and structured RMBS as of September 30, 2016 and December 31, 2015:

(\$ in thousands)

Asset Category	Fair Value	Percentage of Entire Portfolio	Weighted Average Coupon	Weighted Average Maturity in Months	Longest Maturity	Weighted Average Coupon Reset in Months	Weighted Average Lifetime Cap	Weighted Average Periodic Cap
September 30, 2016								
Adjustable Rate RMBS	\$2,076	0.1 %	3.46 %	222	1-Sep-35	8.08	10.05 %	2.00 %
Fixed Rate RMBS	2,332,879	93.3 %	4.23 %	318	1-Sep-46	NA	NA	NA
Hybrid Adjustable Rate RMBS	48,764	1.9 %	2.55 %	316	1-Aug-43	76.08	7.55 %	2.00 %
Total Mortgage-backed Pass-through	2,383,719	95.3 %	4.19 %	318	1-Sep-46	NA	NA	NA
Interest-Only Securities	51,174	2.0 %	3.53 %	226	25-Apr-45	NA	NA	NA
Inverse Interest-Only Securities	66,604	2.7 %	5.65 %	336	25-Sep-46	NA	6.17 %	NA
Total Structured RMBS	117,778	4.7 %	4.73 %	288	25-Sep-46	NA	NA	NA
Total Mortgage Assets	\$2,501,497	100.0 %	4.22 %	316	25-Sep-46	NA	NA	NA
December 31, 2015								
Adjustable Rate RMBS	\$2,976	0.1 %	3.63 %	224	1-Sep-35	4.10	10.04 %	2.00 %
Fixed Rate RMBS	2,000,623	92.7 %	4.22 %	315	1-Dec-45	NA	NA	NA
Hybrid Adjustable Rate RMBS	52,238	2.4 %	2.55 %	325	1-Aug-43	84.93	7.55 %	2.00 %
Total Mortgage-backed Pass-through	2,055,837	95.2 %	4.18 %	315	1-Dec-45	NA	NA	NA
Interest-Only Securities	61,574	2.9 %	3.58 %	250	25-Apr-45	NA	NA	NA
Inverse Interest-Only Securities	40,599	1.9 %	5.97 %	320	15-Apr-45	NA	6.36 %	NA
Total Structured RMBS	102,173	4.8 %	4.53 %	278	25-Apr-45	NA	NA	NA
Total Mortgage Assets	\$2,158,010	100.0 %	4.19 %	313	1-Dec-45	NA	NA	NA

(\$ in thousands)

Agency	September 30, 2016			December 31, 2015		
	Fair Value	Percentage of Entire Portfolio		Fair Value	Percentage of Entire Portfolio	
Fannie Mae	\$1,967,076	78.6 %		\$1,747,699	81.0 %	
Freddie Mac	526,476	21.0 %		394,256	18.3 %	
Ginnie Mae	7,945	0.4 %		16,055	0.7 %	
Total Portfolio	\$2,501,497	100.0 %		\$2,158,010	100.0 %	

	September 30, 2016	December 31, 2015
Weighted Average Pass-through Purchase Price	\$ 109.09	\$ 108.05
Weighted Average Structured Purchase Price	\$ 15.02	\$ 14.18
Weighted Average Pass-through Current Price	\$ 110.36	\$ 107.56

Edgar Filing: Orchid Island Capital, Inc. - Form 10-Q

Weighted Average Structured Current Price	\$ 13.60	\$ 14.17
Effective Duration ⁽¹⁾	2.438	2.753

Effective duration is the approximate percentage change in price for a 100 bps change in rates. An effective duration of 2.438 indicates that an interest rate increase of 1.0% would be expected to cause a 2.438% decrease in the value of the RMBS in the Company's investment portfolio at September 30, 2016. An effective duration of (1)2.753 indicates that an interest rate increase of 1.0% would be expected to cause a 2.753% decrease in the value of the RMBS in the Company's investment portfolio at December 31, 2015. These figures include the structured securities in the portfolio, but do not include the effect of the Company's funding cost hedges. Effective duration quotes for individual investments are obtained from The Yield Book, Inc.

The following table presents a summary of portfolio assets acquired during the nine months ended September 30, 2016 and 2015.

(\$ in thousands)

	2016			2015			
	Total Cost	Average Price	Weighted Average Yield	Total Cost	Average Price	Weighted Average Yield	
Pass-through RMBS	\$2,204,085	\$109.70	2.24 %	\$2,138,728	\$107.69	2.50 %	
Structured RMBS	52,897	18.03	5.46 %	59,582	14.55	2.80 %	

Borrowings

As of September 30, 2016, we had established borrowing facilities in the repurchase agreement market with a number of commercial banks and other financial institutions and had borrowings in place with 19 of these counterparties. None of these lenders are affiliated with the Company. These borrowings are secured by the Company's RMBS and cash, and bear interest rates that are based on a spread to LIBOR. During the fourth quarter of 2015, the Company, through its captive insurance subsidiary Orchid Island Casualty, LLC, became a member of the Federal Home Loan Bank ("FHLB") of Cincinnati and received its first advance in December of 2015. On January 12, 2016, the regulator of the FHLB system, the Federal Housing Finance Administration ("FHFA") issued a final ruling that, among other things, eliminated the ability of captive insurance subsidiaries such as Orchid Island Casualty, LLC to receive advances from the FHLB of Cincinnati. While the Company no longer has access to advances from the FHLB of Cincinnati, we believe our other established repurchase agreement borrowing facilities provide borrowing capacity in excess of our needs.

As of September 30, 2016, we had obligations outstanding under the repurchase agreements of approximately \$2,298.1 million with a net weighted average borrowing cost of 0.73%. The remaining maturity of our outstanding repurchase agreement obligations ranged from 3 to 56 days, with a weighted average remaining maturity of 13 days. Securing the repurchase agreement obligations as of September 30, 2016 are RMBS with an estimated fair value, including accrued interest and securities pledged related to securities sold but not yet settled, of approximately \$2,431.3 million and a weighted average maturity of 316 months, and cash pledged to counterparties of approximately \$8.1 million. Through November 1, 2016, we have been able to maintain our repurchase facilities with comparable terms to those that existed at September 30, 2016 with maturities through January 23, 2017.

The table below presents information about our period end and average repurchase agreement obligations for each quarter in 2016 and 2015.

(\$ in thousands)

Three Months Ended	Ending Balance of Borrowings	Average Balance of Borrowings	Difference Between Ending Borrowings and Average Borrowings	
			Amount	Percent
September 30, 2016	\$2,298,097	\$2,179,462	\$118,635	5.44 %
June 30, 2016	2,060,827	2,000,158	60,669	3.03 %
March 31, 2016	1,939,489	1,962,901	(23,412)	(1.19)%
December 31, 2015	1,986,313	1,964,806	21,507	1.09 %
September 30, 2015	1,943,299	1,978,685	(35,386)	(1.79)%
June 30, 2015	2,014,071	1,736,781	277,290	15.97 % ⁽¹⁾

Edgar Filing: Orchid Island Capital, Inc. - Form 10-Q

March 31, 2015 1,459,490 1,448,071 11,419 0.79 %

The higher ending balance relative to the average balance during the quarter ended June 30, 2015 reflects the deployment of the proceeds, on a leveraged basis, of the Company's share issuances under the March 2015 Equity (1) Distribution Agreement. During the quarter ended June 30, 2015, the Company's investment in PT RMBS increased \$457.4 million.

-37-

Liquidity and Capital Resources

Liquidity is our ability to turn non-cash assets into cash, purchase additional investments, repay principal and interest on borrowings, fund overhead, fulfill margin calls and pay dividends. Our principal immediate sources of liquidity include cash balances, unencumbered assets and borrowings under repurchase agreements. Our borrowing capacity will vary over time as the market value of our interest earning assets varies. Our balance sheet also generates liquidity on an on-going basis through payments of principal and interest we receive on our RMBS portfolio. Management believes that we currently have sufficient liquidity and capital resources available for (a) the acquisition of additional investments consistent with the size and nature of our existing RMBS portfolio, (b) the repayments on borrowings and (c) the payment of dividends to the extent required for our continued qualification as a REIT. We may also generate liquidity from time to time by selling our equity or debt securities in public offerings or private placements.

Because our PT RMBS portfolio consists entirely of government and agency securities, we do not anticipate having difficulty converting our assets to cash should our liquidity needs ever exceed our immediately available sources of cash. Our structured RMBS portfolio also consists entirely of governmental agency securities, although they typically do not trade with comparable bid / ask spreads as PT RMBS. However, we anticipate that we would be able to liquidate such securities readily, even in distressed markets, although we would likely do so at prices below where such securities could be sold in a more stable market. To enhance our liquidity even further, we may pledge a portion of our structured RMBS as part of a repurchase agreement funding, but retain the cash in lieu of acquiring additional assets. In this way we can, at a modest cost, retain higher levels of cash on hand and decrease the likelihood we will have to sell assets in a distressed market in order to raise cash.

Our strategy for hedging our funding costs typically involves taking short positions in interest rate futures, treasury futures, interest rate swaps, interest rate swaptions or other instruments. Since inception we have primarily used short positions in Eurodollar futures. When the market causes these short positions to decline in value we are required to meet margin calls with cash. This can reduce our liquidity position to the extent other securities in our portfolio move in price in such a way that we do not receive enough cash via margin calls to offset the derivative related margin calls. If this were to occur in sufficient magnitude, the loss of liquidity might force us to reduce the size of the levered portfolio, pledge additional structured securities to raise funds or risk operating the portfolio with less liquidity.

Our master repurchase agreements have no stated expiration, but can be terminated at any time at our option or at the option of the counterparty. However, once a definitive repurchase agreement under a master repurchase agreement has been entered into, it generally may not be terminated by either party. A negotiated termination can occur, but may involve a fee to be paid by the party seeking to terminate the repurchase agreement transaction.

Under our repurchase agreement funding arrangements, we are required to post margin at the initiation of the borrowing. The margin posted represents the haircut, which is a percentage of the market value of the collateral pledged. To the extent the market value of the asset collateralizing the financing transaction declines, the market value of our posted margin will be insufficient and we will be required to post additional collateral. Conversely, if the market value of the asset pledged increases in value, we would be over collateralized and we would be entitled to have excess margin returned to us by the counterparty. Our lenders typically value our pledged securities daily to ensure the adequacy of our margin and make margin calls as needed, as do we. Typically, but not always, the parties agree to a minimum threshold amount for margin calls so as to avoid the need for nuisance margin calls on a daily basis. Our master repurchase agreements do not specify the haircut; rather haircuts are determined on an individual repurchase transaction basis. Throughout the nine months ended September 30, 2016, haircuts on our pledged collateral remained stable and as of September 30, 2016, our weighted average haircut was approximately 5.4% of the value of our collateral.

As discussed earlier, we invest a portion of our capital in structured Agency RMBS. We do not apply leverage to this portion of our portfolio. The leverage inherent in structured securities replaces the leverage obtained by acquiring PT

securities and funding them in the repurchase market. This structured RMBS strategy has been a core element of the Company's overall investment strategy since inception. However, we have and may continue to pledge a portion of our structured RMBS in order to raise our cash levels, but generally will not pledge these securities in order to acquire additional assets.

-38-

The following table summarizes the effect on our liquidity and cash flows from contractual obligations for repurchase agreements and interest expense on repurchase agreements.

(in thousands)

	Obligations Maturing				Total
	Within One Year	One to Three Years	Three to Five Years	More than Five Years	
Repurchase agreements	\$2,298,097	\$ -	\$ -	\$ -	\$2,298,097
Interest expense on repurchase agreements ⁽¹⁾	2,440	-	-	-	2,440
Unsettled securities purchased	72,343	-	-	-	72,343
Totals	\$2,372,880	\$ -	\$ -	\$ -	\$2,372,880

(1) Interest expense on repurchase agreements is based on current interest rates as of September 30, 2016 and the remaining term of the liabilities existing at that date.

In future periods, we expect to continue to finance our activities in a manner that is consistent with our current operations through repurchase agreements. As of September 30, 2016, we had cash and cash equivalents of \$110.9 million. We generated cash flows of \$239.5 million from principal and interest payments on our RMBS and had average repurchase agreements outstanding of \$2,047.5 million during the nine months ended September 30, 2016.

Stockholders' Equity

In January 2014, we completed a public offering of 2,070,000 shares of our common stock (including 270,000 shares sold pursuant to the full exercise of the overallotment option granted to the underwriters which closed on January 29, 2014) for aggregate net proceeds of approximately \$24.2 million after deducting underwriters' discounts and commissions and offering expenses.

In March 2014, we completed a public offering of 3,680,000 shares of our common stock (including 480,000 shares sold pursuant to the full exercise of the overallotment option granted to the underwriters which closed on April 11, 2014) for aggregate net proceeds of approximately \$44.0 million after deducting underwriters' discounts and commissions and offering expenses.

On June 17, 2014, we entered into an equity distribution agreement (the "June 2014 Equity Distribution Agreement") with two sales agents pursuant to which we could offer and sell, from time to time, up to an aggregate amount of \$35,000,000 of shares of our common stock in transactions that were deemed to be "at the market" offerings and privately negotiated transactions. We issued a total of 2,528,416 shares under the June 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$34.2 million, net of commissions and fees, prior to its termination.

On September 3, 2014, we entered into a second equity distribution agreement (the "September 2014 Equity Distribution Agreement") with two sales agents pursuant to which we could offer and sell, from time to time, up to an aggregate amount of \$75,000,000 of shares of our common stock in transactions that were deemed to be "at the market" offerings and privately negotiated transactions. The September 2014 Equity Distribution Agreement replaced the June 2014 Equity Distribution Agreement. We issued a total of 5,087,646 shares under the September 2014 Equity Distribution Agreement for aggregate proceeds of approximately \$69.1 million, net of commissions and fees, prior to its termination.

On March 2, 2015, we entered into a third equity distribution agreement (the "March 2015 Equity Distribution Agreement") with two sales agents pursuant to which we may offer and sell, from time to time, up to an aggregate amount of \$100,000,000 of shares of our common stock in transactions that are deemed to be "at the market" offerings and privately negotiated transactions. The March 2015 Equity Distribution Agreement replaced the September 2014 Equity Distribution Agreement. We issued a total of 7,218,766 shares under the March 2015 Equity Distribution Agreement for aggregate proceeds of approximately \$93.2 million, net of commissions and fees, prior to its termination.

On July 29, 2016, we entered into a fourth equity distribution agreement (the "July 2016 Equity Distribution Agreement") with two sales agents pursuant to which we may offer and sell, from time to time, up to an aggregate amount of \$125,000,000 of shares of our common stock in transactions that are deemed to be "at the market" offerings and privately negotiated transactions. The July 2016 Equity Distribution Agreement replaced the March 2015 Equity Distribution Agreement. Through September 30, 2016, we had issued a total of 3,467,891 shares under the July 2016 Equity Distribution Agreement for aggregate proceeds of approximately \$37.0 million, net of commissions and fees.

On July 29, 2015 the Company's Board of Directors authorized the repurchase of up to 2,000,000 shares of our common stock. The timing, manner, price and amount of any repurchases will be determined by the Company in its discretion and will be subject to economic and market conditions, stock price, applicable legal requirements and other factors. The authorization does not obligate the Company to acquire any particular amount of common stock and the program may be suspended or discontinued at the Company's discretion without prior notice. From the inception of the share repurchase program through September 30, 2016, we repurchased a total of 1,216,243 shares for aggregate costs of approximately \$10.8 million, including commissions and fees, for a weighted average price of \$8.92 per share.

Outlook

Interest Rates

The economic trends in place over the course of the first and second quarters of 2016 reversed in the third quarter and into the fourth. The broadest measure of economic growth in the United States, gross domestic product, or "GDP", appears to have rebounded back to around 2%, the level widely considered to be at or slightly above trend growth in the United States in the post Great Recession world. Interest rates, after falling precipitously early in the year and again after passage of the referendum in the United Kingdom known as "Brexit", have since stabilized and, earlier this month, moved back above levels seen just before the Brexit vote on June 23, 2016. In fact, the yield on the 10 year US Treasury reached an all-time low yield shortly after the Brexit vote. However, while the slow growth witnessed in the US over the first half of the year has ended, economic growth is by no means robust. Many of the drags on growth, predominantly in the manufacturing and energy sectors, have stabilized but not recovered meaningfully. The strongest sectors of the economy, the housing, consumer and labor markets, continue to perform relatively well and drive economic growth. However, the net of all this activity appears to be modest growth accompanied by increasing, but not excessive, inflation. These conditions should allow the Federal Reserve (the "Fed") to remove accommodation at a very gradual pace. To wit, the market now expects the Fed to raise rates before year end, probably at its December meeting. Public comments by various Fed governors and committee members have been consistent in supporting this expectation. Assuming incoming economic data remains supportive and financial conditions do not deteriorate, we expect the Fed to move rates higher by 25 bps at its December meeting. Nonetheless, it is equally likely, in the eyes of most market participants, that the Fed will not raise rates aggressively in 2017 and beyond. Public comments by the Fed officials described above are also consistent with this expectation. Accordingly, we expect the level of the U.S. Federal Funds rate ("Fed Funds"), and funding levels generally, only to move modestly higher over the next few years.

With this backdrop in the economy and rates market, the mortgage market has performed well over the course of the third quarter of 2016. From a price perspective, the slight increase in rates over the course of the third quarter – the US treasury curve flattened modestly as two year yields increased by approximately 17.5 bps while the ten year treasury yields increased by approximately 12.5 bps – coupled with expectations that prepayment speeds would moderate, enabled 30 year fixed rate mortgages to tighten in spread to comparable duration treasuries. In fact, with rates up, prices of 30 year fixed rate 3% through 4.5% securities increased. The same is true of higher coupon 15 year, fixed rate securities, although to a lesser extent. From a prepayment perspective, speeds accelerated into the late summer post-Brexit and appear to have peaked in August, based on the report issued in early September. However, speeds moderated only modestly in September, based on the report issued in early October. Going forward, the combination of higher rates – the MBA survey rate issued on October 20, 2016 was the highest since just before the Brexit vote – coupled with the seasonal slowdown in prepayments, should cause prepayment rates to decrease further. This in turn should be supportive of mortgage valuations. In addition, the Fed appears intent on continuing the reinvestment of pay-downs on its MBS holdings, and banks, particularly large banks, continue to add to their MBS holdings, both in securitized and whole-loan form. Both of these trends are supportive of mortgage valuations as well. A potential pitfall would be if the Fed, in an effort to steepen the curve, terminated, or significantly reduced, its reinvestment of pay-downs. Governor Eric Rosengren of the Boston Fed recently hinted at this possibility, although Fed leadership, Chair Yellen, Vice Chair Fischer and NY Fed governor Dudley, have not.

A second consideration for mortgage valuations is pay-up premiums on call-protected securities. Orchid has a significant allocation of its portfolio in these securities. In spite of the increase in rates during the third quarter, and continuing into the fourth quarter, such pay-up premiums remain elevated, consistent with prepayment speeds. Going forward, if prepayment speeds moderate further, call-protected security pay-up premiums could diminish. The Company has reduced exposure to such securities gradually over the course of the third quarter and to date in the fourth quarter, while weighing the potential risks of continued pay-up premium erosion versus the need for prepayment protection as speeds have moderated only modestly so far.

Recent Regulatory Developments

On January 12, 2016, the FHFA issued RIN 2590-AA39, Members of Federal Home Loan Banks (the "Final Rule"). The Final Rule, among other things, expressly excludes captive insurance companies, such as our wholly-owned captive insurance subsidiary, Orchid Island Casualty, LLC ("Orchid Island Casualty"), from being eligible for membership in the FHLB system. Under the Final Rule, there is a one-year transition period from the effective date of February 19, 2016 within which the FHLBs must wind down their relationships with any captive insurance companies that had been admitted to membership on or after September 12, 2014, including Orchid Island Casualty ("Post-NPR Captives"). The Final Rule also precludes the FHLBs from making any new advances or extending existing advances to Post-NPR Captives. In addition, upon the termination of membership, the FHLBs must liquidate all outstanding advances to Post-NPR Captives, settle all other business transactions, and repurchase or redeem all FHLB stock held by the terminated Post-NPR Captive in accordance with the Final Rule. Therefore, Orchid Island Casualty, along with all other Post-NPR Captives, must completely wind down all business relationships with the FHLBC, including the repayment of all outstanding advances, prior to or simultaneously with the termination of Orchid Island Casualty's membership with the FHLBC.

The adopting release for the Final Rule expressly invited Congress to address the treatment of Post-NPR Captives with respect to membership in the FHLB. In October 2015, Reps. Blaine Luetkemeyer (R-Mo.), Denny Heck (D-Wash.), Patrick McHenry (R-N.C.) and John Carney (D-Del.) introduced H.R. 3808, a bill that would have preemptively prevented the FHFA from adopting the Final Rule in such a way that would foreclose membership in the FHLB to captive insurance companies. There can be no way of predicting if any subsequent legislation addressing the status of Post-NPR Captives with respect to the FHLB will be proposed in either house of Congress, the likelihood of passage of any such legislation, and the ultimate effects, if any, on the availability of short-term, low-cost funding provided by the FHLBs to Post-NPR Captives subsequent to the enactment of any such legislation.

Effect on Us

Regulatory developments, movements in interest rates and prepayment rates as well as loan modification programs affect us in many ways, including the following:

Effects on our Assets

A change in or elimination of the guarantee structure of Agency RMBS may increase our costs (if, for example, guarantee fees increase) or require us to change our investment strategy altogether. For example, the elimination of the guarantee structure of Agency RMBS may cause us to change our investment strategy to focus on non-Agency RMBS, which in turn would require us to significantly increase our monitoring of the credit risks of our investments in addition to interest rate and prepayment risks.

Lower long-term interest rates can affect the value of our Agency RMBS in a number of ways. If prepayment rates are relatively low (due, in part, to the refinancing problems described above), lower long-term interest rates can increase the value of higher-coupon Agency RMBS. This is because investors typically place a premium on assets with yields that are higher than market yields. Although lower long-term interest rates may increase asset values in our portfolio, we may not be able to invest new funds in similarly-yielding assets.

If prepayment levels increase, the value of our Agency RMBS affected by such prepayments may decline. This is because a principal prepayment accelerates the effective term of an Agency RMBS, which would shorten the period during which an investor would receive above-market returns (assuming the yield on the prepaid asset is higher than market yields). Also, prepayment proceeds may not be able to be reinvested in similar-yielding assets. Agency RMBS backed by mortgages with high interest rates are more susceptible to prepayment risk because holders of those mortgages are most likely to refinance to a lower rate. IOs and IIOs, however, may be the types of Agency RMBS most sensitive to increased prepayment rates. Because the holder of an IO or IIO receives no principal payments, the values of IOs and IIOs are entirely dependent on the existence of a principal balance on the underlying mortgages. If the principal balance is eliminated due to prepayment, IOs and IIOs essentially become worthless. Although increased prepayment rates can negatively affect the value of our IOs and IIOs, they have the opposite effect on POs. Because POs act like zero-coupon bonds, meaning they are purchased at a discount to their par value and have an effective interest rate based on the discount and the term of the underlying loan, an increase in prepayment rates would reduce the effective term of our POs and accelerate the yields earned on those assets, which would increase our net income.

Because we base our investment decisions on risk management principles rather than anticipated movements in interest rates, in a volatile interest rate environment we may allocate more capital to structured Agency RMBS with shorter durations, such as short-term fixed and floating rate CMOs. We believe these securities have a lower sensitivity to changes in long-term interest rates than other asset classes. We may attempt to mitigate our exposure to changes in long-term interest rates by investing in IOs and IIOs, which typically have different sensitivities to changes in long-term interest rates than pass-through Agency RMBS, particularly pass-through Agency RMBS backed by fixed-rate mortgages.

We do not believe our investment portfolio will be materially affected by loan modification programs because Agency RMBS backed by loans that would qualify for such programs (e.g., seriously delinquent loans) will be purchased by Fannie Mae and Freddie Mac at their par value prior to the implementation of such programs. However, if Fannie Mae and Freddie Mac were to modify or end their repurchase programs or if the U.S. government modified its loan modification programs to modify non-delinquent mortgage loans, our investment portfolio could be negatively impacted.

Effects on our borrowing costs

We leverage our pass-through Agency RMBS portfolio and a portion of our structured Agency RMBS with principal balances through the use of short-term repurchase agreement transactions. The interest rates on our debt are determined by market levels of both the Fed Funds Rate and LIBOR. An increase in the Fed Funds Rate or LIBOR would increase our borrowing costs, which could affect our interest rate spread if there is no corresponding increase in the interest we earn on our assets. This would be most prevalent with respect to our Agency RMBS backed by fixed rate mortgage loans because the interest rate on a fixed-rate mortgage loan does not change even though market rates may change.

We believe that we have ample borrowing capacity. However, since January 12, 2016, in response to the Final Rule on FHLB membership (described above), we replaced \$187.5 million of FHLB advances held as of December 31, 2015 with borrowings from other counterparties under repurchase agreements. The Final Rule on FHLB membership requires the termination of Orchid Island Casualty's FHLBC membership prior to February 19, 2017. The Company does not expect these regulatory changes to materially adversely affect its core business and operations.

In order to protect our net interest margin against increases in short-term interest rates, we may enter into interest rate swaps, which effectively convert our floating-rate repurchase agreement debt to fixed-rate debt, or utilize other hedging instruments such as Eurodollar and T-Note futures contracts or interest rate swaptions.

Summary

Over the past quarter, volatility in the rates market moderated and financial conditions stabilized, particularly as fears over the UK Brexit Referendum appear to have been over-done, at least for the short to medium term. As interest rates stopped decreasing and eventually increased slightly during the third quarter, mortgage securities performed well, especially higher coupon, fixed rate securities. These developments have positively affected our book value as the spread between Agency RMBS and benchmark interest rates narrowed during the third quarter. Prepayment rates increased during the third quarter as longer term rates declined during the second quarter and early third quarter, but have since begun to moderate. The markets' expectations of the timing of Federal Reserve increases in interest rates have coalesced around a 25 bps hike at the December Federal Open Market Committee meeting. Nonetheless, economic data, as it is released, will continue to have a significant impact in shaping market expectations. These developments are very important to our results as increases in the Federal Funds Rate and LIBOR could increase our financing costs, which could lower our net interest margin.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with GAAP. GAAP requires our management to make some complex and subjective decisions and assessments. Our most critical accounting policies involve decisions and assessments which could significantly affect reported assets, liabilities, revenues and expenses. There have been no changes to our critical accounting policies as discussed in our annual report on Form 10-K for the year ended December 31, 2015.

Capital Expenditures

At September 30, 2016, we had no material commitments for capital expenditures.

Off-Balance Sheet Arrangements

At September 30, 2016, we did not have any off-balance sheet arrangements.

Dividends

In addition to other requirements that must be satisfied to qualify as a REIT, we must pay annual dividends to our stockholders of at least 90% of our REIT taxable income, determined without regard to the deduction for dividends paid and excluding any net capital gains. REIT taxable income (loss) is computed in accordance with the Code, and can be greater than or less than our financial statement net income (loss) computed in accordance with GAAP. These book to tax differences primarily relate to the recognition of interest income on RMBS, unrealized gains and losses on RMBS, and the amortization of losses on derivative instruments that are treated as funding hedges for tax purposes.

In general, dividends declared by us will be considered ordinary income to stockholders for U.S. federal income tax purposes. From time to time, a portion of our dividends may be characterized as capital gains or return of capital. For the tax period ended December 31, 2015, all income distributed in the form of dividends declared was considered characterized as ordinary income. We intend to pay regular monthly dividends to our stockholders and have declared the following dividends since the completion of our IPO.

(in thousands, except per share amounts)

Year	Per Share Amount	Total
2013	\$ 1.395	\$4,662
2014	2.160	22,643
2015	1.920	38,748
2016 - YTD ⁽¹⁾	1.400	32,546
Totals	\$ 6.875	\$98,599

On October 12, 2016, the Company declared a dividend of \$0.14 per share to be paid on October 31, 2016. The (1)effect of this dividend is included in the table above but is not reflected in the Company's financial statements as of September 30, 2016.

Inflation

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our consolidated financial statements are prepared in accordance with GAAP and our distributions will be determined by our Board of Directors consistent with our obligation to distribute to our stockholders at least 90% of our REIT taxable income on an annual basis in order to maintain our REIT qualification; in each case, our activities and balance sheet are measured with reference to historical cost and/or fair market value without considering inflation.

Jumpstart Our Business Startups Act of 2012

We are an "emerging growth company" as defined in the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"). The JOBS Act permits emerging growth companies to take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies. We have elected to "opt out" of this provision and, as a result, we will be required to comply with new or revised accounting standards as required when they are adopted. The decision to opt out of the extended transition period under the JOBS Act is irrevocable.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the exposure to loss resulting from changes in market factors such as interest rates, foreign currency exchange rates, commodity prices and equity prices. The primary market risks that we are exposed to are interest rate risk, prepayment risk, spread risk, liquidity risk, extension risk and counterparty credit risk.

Interest Rate Risk

Interest rate risk is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control.

Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities, by affecting the spread between our interest-earning assets and interest-bearing liabilities. Changes in the level of interest rates can also affect the rate of prepayments of our securities and the value of the RMBS that constitute our investment portfolio, which affects our net income and ability to realize gains from the sale of these assets and impacts our ability to borrow and the amount that we can borrow against these securities.

We may utilize a variety of financial instruments in order to limit the effects of changes in interest rates on our operations. The principal instruments that we use are futures contracts and options to enter into interest rate swaps. These instruments are intended to serve as a hedge against future interest rate increases on our repurchase agreement borrowings. Hedging techniques are partly based on assumed levels of prepayments of our Agency RMBS. If prepayments are slower or faster than assumed, the life of the Agency RMBS will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns. Hedging techniques are also limited by the rules relating to REIT qualification. In order to preserve our REIT status, we may be forced to terminate a hedging transaction at a time when the transaction is most needed.

Our profitability and the value of our investment portfolio (including derivatives used for hedging purposes) may be adversely affected during any period as a result of changing interest rates including changes in the forward yield curve.

Our portfolio of PT RMBS is typically comprised of adjustable-rate RMBS, fixed-rate RMBS and hybrid adjustable-rate RMBS. We generally seek to acquire low duration assets that offer high levels of protection from mortgage prepayments provided they are reasonably priced by the market. Although the duration of an individual asset can change as a result of changes in interest rates, we strive to maintain a hedged PT RMBS portfolio with an effective duration of less than 2.0. The stated contractual final maturity of the mortgage loans underlying our portfolio of PT RMBS generally ranges up to 30 years. However, the effect of prepayments of the underlying mortgage loans tends to shorten the resulting cash flows from our investments substantially. Prepayments occur for various reasons, including refinancing of underlying mortgages and loan payoffs in connection with home sales.

The duration of our IO and IIO portfolios will vary greatly depending on the structural features of the securities. While prepayment activity will always affect the cash flows associated with the securities, the interest only nature of IOs may cause their durations to become extremely negative when prepayments are high, and less negative when prepayments are low. Prepayments affect the durations of IIOs similarly, but the floating rate nature of the coupon of IIOs (which is inversely related to the level of one month LIBOR) cause their price movements, and model duration, to be affected by changes in both prepayments and one month LIBOR, both current and anticipated levels. As a result, the duration of IIO securities will also vary greatly.

Prepayments on the loans underlying our RMBS can alter the timing of the cash flows from the underlying loans to us. As a result, we gauge the interest rate sensitivity of our assets by measuring their effective duration. While modified duration measures the price sensitivity of a bond to movements in interest rates, effective duration captures both the movement in interest rates and the fact that cash flows to a mortgage related security are altered when interest rates move. Accordingly, when the contract interest rate on a mortgage loan is substantially above prevailing interest rates in the market, the effective duration of securities collateralized by such loans can be quite low because of expected prepayments.

We face the risk that the market value of our PT RMBS assets will increase or decrease at different rates than that of our structured RMBS or liabilities, including our hedging instruments. Accordingly, we assess our interest rate risk by estimating the duration of our assets and the duration of our liabilities. We generally calculate duration using various third party models. However, empirical results and various third party models may produce different duration numbers for the same securities.

The following sensitivity analysis shows the estimated impact on the fair value of our interest rate-sensitive investments and hedge positions as of September 30, 2016 and December 31, 2015, assuming rates instantaneously fall 100 basis points ("bps"), fall 50 bps, rise 50 bps and rise 100 bps, adjusted to reflect the impact of convexity, which is the measure of the sensitivity of our hedge positions and Agency RMBS' effective duration to movements in interest rates.

All changes in value in the table below are measured as percentage changes from the investment portfolio value and net asset value at the base interest rate scenario. The base interest rate scenario assumes interest rates and prepayment projections as of September 30, 2016 and December 31, 2015. We apply a floor of 0% for the down rate scenarios on our interest bearing liabilities and hedge positions, such that any hypothetical interest rate decrease would have a limited positive impact on our funding costs beyond a certain level.

Actual results could differ materially from estimates, especially in the current market environment. To the extent that these estimates or other assumptions do not hold true, which is likely in a period of high price volatility, actual results will likely differ materially from projections and could be larger or smaller than the estimates in the table below. Moreover, if different models were employed in the analysis, materially different projections could result. Lastly, while the table below reflects the estimated impact of interest rate increases and decreases on a static portfolio, we may from time to time sell any of our agency securities as a part of our overall management of our investment portfolio.

Interest Rate Sensitivity⁽¹⁾

Change in Interest Rate	Portfolio	
	Market Value ⁽²⁾⁽³⁾	Book Value ⁽²⁾⁽⁴⁾
As of September 30, 2016		
-100 Basis Points	(0.34)%	(2.92)%
-50 Basis Points	0.09%	0.79%
+50 Basis Points	(0.73)%	(6.21)%
+100 Basis Points	(1.98)%	(16.83)%
As of December 31, 2015		
-100 Basis Points	(0.03)%	(0.21)%
-50 Basis Points	0.20%	1.75%
+50 Basis Points	(0.72)%	(6.16)%
+100 Basis Points	(2.10)%	(17.90)%

(1)

Interest rate sensitivity is derived from models that are dependent on inputs and assumptions provided by third parties as well as by our Manager, and assumes there are no changes in mortgage spreads and assumes a static portfolio. Actual results could differ materially from these estimates.

- (2) Includes the effect of derivatives and other securities used for hedging purposes.
- (3) Estimated dollar change in investment portfolio value expressed as a percent of the total fair value of our investment portfolio as of such date.
- (4) Estimated dollar change in portfolio value expressed as a percent of stockholders' equity as of such date.

In addition to changes in interest rates, other factors impact the fair value of our interest rate-sensitive investments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, in the event of changes in actual interest rates, the change in the fair value of our assets would likely differ from that shown above and such difference might be material and adverse to our stockholders.

Prepayment Risk

Because residential borrowers have the option to prepay their mortgage loans at par at any time, we face the risk that we will experience a return of principal on our investments faster than anticipated. Various factors affect the rate at which mortgage prepayments occur, including changes in the level of and directional trends in housing prices, interest rates, general economic conditions, loan age and size, loan-to-value ratio, the location of the property and social and demographic conditions. Additionally, changes to GSE underwriting practices or other governmental programs could also significantly impact prepayment rates or expectations. Generally, prepayments on Agency RMBS increase during periods of falling mortgage interest rates and decrease during periods of rising mortgage interest rates. However, this may not always be the case. We may reinvest principal repayments at a yield that is lower or higher than the yield on the repaid investment, thus affecting our net interest income by altering the average yield on our assets.

Spread Risk

When the market spread widens between the yield on our Agency RMBS and benchmark interest rates, our net book value could decline if the value of our Agency RMBS fall by more than the offsetting fair value increases on our hedging instruments tied to the underlying benchmark interest rates. We refer to this as "spread risk" or "basis risk." The spread risk associated with our mortgage assets and the resulting fluctuations in fair value of these securities can occur independent of changes in benchmark interest rates and may relate to other factors impacting the mortgage and fixed income markets, such as actual or anticipated monetary policy actions by the Federal Reserve, market liquidity, or changes in required rates of return on different assets. Consequently, while we use futures contracts and interest rate swaps and swaptions to attempt to protect against moves in interest rates, such instruments typically will not protect our net book value against spread risk.

Liquidity Risk

The primary liquidity risk for us arises from financing long-term assets with shorter-term borrowings through repurchase agreements. Our assets that are pledged to secure repurchase agreements are Agency RMBS and cash. As of September 30, 2016, we had unrestricted cash and cash equivalents of \$110.9 million and unpledged securities of approximately \$97.4 million (not including securities pledged to us) available to meet margin calls on our repurchase agreements and derivative contracts and for other corporate purposes. However, should the value of our Agency RMBS pledged as collateral or the value of our derivative instruments suddenly decrease, margin calls relating to our repurchase and derivative agreements could increase, causing an adverse change in our liquidity position. Further, there is no assurance that we will always be able to renew (or roll) our repurchase agreements. In addition, our counterparties have the option to increase our haircuts (margin requirements) on the assets we pledge, against repurchase agreements thereby reducing the amount that can be borrowed against an asset even if they agree to renew or roll the repurchase agreement. Significantly higher haircuts can reduce our ability to leverage our portfolio or even force us to sell assets, especially if correlated with asset price declines or faster prepayment rates on our assets.

Extension Risk

The projected weighted average life and the duration (or interest rate sensitivity) of our investments is based on our Manager's assumptions regarding the rate at which the borrowers will prepay the underlying mortgage loans. In general, we use futures contracts and interest rate swaptions to help manage our funding cost on our investments in the event that interest rates rise. These hedging instruments allow us to reduce our funding exposure on the notional amount of the instrument for a specified period of time.

However, if prepayment rates decrease in a rising interest rate environment, the average life or duration of our fixed-rate assets or the fixed-rate portion of the ARMs or other assets generally extends. This could have a negative impact on our results from operations, as our hedging instrument expirations are fixed and will, therefore, cover a smaller percentage of our funding exposure on our mortgage assets to the extent that their average lives increase due to slower prepayments. This situation may also cause the market value of our agency securities collateralized by fixed rate mortgages or hybrid ARMs to decline by more than otherwise would be the case while most of our hedging instruments would not receive any incremental offsetting gains. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur realized losses.

Counterparty Credit Risk

We are exposed to counterparty credit risk relating to potential losses that could be recognized in the event that the counterparties to our repurchase agreements and derivative contracts fail to perform their obligations under such agreements. The amount of assets we pledge as collateral in accordance with our agreements varies over time based on the market value and notional amount of such assets as well as the value of our derivative contracts. In the event of a default by a counterparty, we may not receive payments provided for under the terms of our agreements and may have difficulty obtaining our assets pledged as collateral under such agreements. Our credit risk related to certain derivative transactions is largely mitigated through daily adjustments to collateral pledged based on changes in market value and we limit our counterparties to major financial institutions with acceptable credit ratings. However, there is no guarantee our efforts to manage counterparty credit risk will be successful and we could suffer significant losses if unsuccessful.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report (the "evaluation date"), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer (the "CEO") and Chief Financial Officer (the "CFO"), of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act"). Based on this evaluation, the CEO and CFO concluded our disclosure controls and procedures, as designed and implemented, were effective as of the evaluation date (1) in ensuring that information regarding the Company and its subsidiary is accumulated and communicated to our management, including our CEO and CFO, by our employees, as appropriate to allow timely decisions regarding required disclosure and (2) in providing reasonable assurance that information we must disclose in its periodic reports under the Exchange Act is recorded, processed, summarized and reported within the time periods prescribed by the SEC's rules and forms.

Changes in Internal Controls over Financial Reporting

There were no significant changes in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not party to any material pending legal proceedings as described in Item 103 of Regulation S-K.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors disclosed in the "Risk Factors" section of our Annual Report on Form 10-K filed with the SEC on February 25, 2016.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

-49-

ITEM 6. EXHIBITS

Exhibit No.

- Articles of Amendment and Restatement of Orchid Island Capital, Inc. (filed as Exhibit 3.1 to the Company's
- 3.1 Registration Statement on Amendment No. 1 to Form S-11 (File No.333-184538) filed on November 28, 2012 and incorporated herein by reference).
- Amended and Restated Bylaws of Orchid Island Capital, Inc. (filed as Exhibit 3.2 to the Company's
- 3.2 Registration Statement on Amendment No. 1 to Form S-11 (File No.333-184538) filed on November 28, 2012 and incorporated herein by reference).
- Equity Distribution Agreement, dated July 29, 2016, by and between the Orchid Island Capital, Inc., Bimini
- 10.1 Advisors, LLC, Ladenberg Thalmann & Co., Inc. and MUFG Securities Americas, Inc. (filed as Exhibit 1.1 to the Registrant's current report on Form 8-K filed with the Securities Exchange Commission on July 29, 2016, and incorporated herein by reference).
- 31.1 Certification of Robert E. Cauley, Chief Executive Officer and President of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
- 31.2 Certification of G. Hunter Haas, IV, Chief Financial Officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
- 32.1 Certification of Robert E. Cauley, Chief Executive Officer and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
- 32.2 Certification of G. Hunter Haas, IV, Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

Exhibit

101.INS Instance Document ***

XBRL

Exhibit

101.SCH Taxonomy Extension Schema Document ***

XBRL

Exhibit

101.CAL Taxonomy Extension Calculation Linkbase Document***

XBRL

Exhibit

101.DEF Additional Taxonomy Extension Definition Linkbase Document Created***

XBRL

Exhibit

101.LAB Taxonomy Extension Label Linkbase Document ***

XBRL

Exhibit

101.PRE Taxonomy Extension Presentation Linkbase Document ***

XBRL

* Filed herewith.

** Furnished herewith.

*** Submitted electronically herewith.

Edgar Filing: Orchid Island Capital, Inc. - Form 10-Q

Signatures

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

Orchid Island
Capital, Inc.
Registrant

Date: November 1, 2016

By: /s/ Robert E.
Cauley
Robert E. Cauley
Chief Executive
Officer, President
and Chairman of
the Board

Date: November 1, 2016

By: /s/ G. Hunter
Haas, IV
G. Hunter Haas,
IV
Secretary, Chief
Financial Officer,
Chief Investment
Officer and
Director (Principal
Financial and
Accounting
Officer)

INDEX TO EXHIBITS

Exhibit No.

- Articles of Amendment and Restatement of Orchid Island Capital, Inc. (filed as Exhibit 3.1 to the Company's
3.1 Registration Statement on Amendment No. 1 to Form S-11 (File No.333-184538) filed on November 28, 2012
and incorporated herein by reference).
Amended and Restated Bylaws of Orchid Island Capital, Inc. (filed as Exhibit 3.2 to the Company's
3.2 Registration Statement on Amendment No. 1 to Form S-11 (File No.333-184538) filed on November 28, 2012
and incorporated herein by reference).
Equity Distribution Agreement, dated July 29, 2016, by and between the Orchid Island Capital, Inc., Bimini
10.1 Advisors, LLC, Ladenberg Thalmann & Co., Inc. and MUFG Securities Americas, Inc. (filed as Exhibit 1.1 to
the Registrant's current report on Form 8-K filed with the Securities Exchange Commission on July 29, 2016,
and incorporated herein by reference).
31.1 Certification of Robert E. Cauley, Chief Executive Officer and President of the Registrant, pursuant to Section
302 of the Sarbanes-Oxley Act of 2002.*
31.2 Certification of G. Hunter Haas, IV, Chief Financial Officer of the Registrant, pursuant to Section 302 of the
Sarbanes-Oxley Act of 2002.*
32.1 Certification of Robert E. Cauley, Chief Executive Officer and President of the Registrant, pursuant to 18
U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
32.2 Certification of G. Hunter Haas, IV, Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section
1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

Exhibit

101.INS Instance Document ***

XBRL

Exhibit

101.SCH Taxonomy Extension Schema Document ***

XBRL

Exhibit

101.CAL Taxonomy Extension Calculation Linkbase Document***

XBRL

Exhibit

101.DEF Additional Taxonomy Extension Definition Linkbase Document Created***

XBRL

Exhibit

101.LAB Taxonomy Extension Label Linkbase Document ***

XBRL

Exhibit

101.PRE Taxonomy Extension Presentation Linkbase Document ***

XBRL

* Filed herewith.

** Furnished herewith.

*** Submitted electronically herewith.