

President's Letter

1999 was a continuation of the difficulties that the Company experienced as a result of the disruption in the fixed income markets in the second half of 1998. As you most likely know, we suspended the dividend on our common stock in the fourth quarter of 1998, and suspended the dividend on our preferred stocks in the third quarter of 1999. These actions were driven by our need to conserve capital, and the basic principle that dividends are paid out of earnings. Unfortunately, the Company has incurred cumulative losses since the fourth quarter of 1998 of \$92 million. For the year 1999, the Company incurred losses of \$75.1 million, or \$7.67 per common share, versus earnings of \$19.6 million, or \$0.57 per common share, in 1998. I will explain the nature and reason for those losses later in this letter.

As is my practice each year, I use the prior year's "President's Letter" as my starting point for my current year letter. I think the following excerpt from last year's letter is particularly on point:

1999 will be a year of repositioning for the Company. I feel the aftermath of the market forces in late 1998 will continue to affect Dynex and other specialty finance companies well into 1999. Lenders and creditors to this industry sector are very cautious right now, and banks are restricting credit to these type of companies. Dynex has taken and will continue to take steps to protect its balance sheet, conserve its capital, and stay well within all the requirements of our various credit agreements.

1999 was a year of repositioning; certainly more than I had envisioned a year ago. Lenders and creditors have continued to withdraw credit from the "specialty finance" sector and from Dynex in particular. In addition, since the fall of 1998 the capital markets continue to be reluctant to invest in securitizations sponsored by specialty finance companies such as Dynex.

As a result of that environment, it became apparent in the second quarter of 1999 that our production activities were not going to be economic – it is difficult to make money as a lender without a competitive source of funding. Our sources of funding, be it interim lenders such as commercial banks and Wall Street firms, or long term investors in our securitizations, were generally charging specialty finance companies, including Dynex, higher rates or were unwilling to renew credit lines under reasonable terms. This led to our decision to sell during 1999 our model home purchase/leaseback business ("Dynex Residential, Inc." or "DRI") and our manufactured housing lending business ("Dynex Financial, Inc." or "DFI").

DRI was sold to a unit of General Motors in November 1999. We recognized a gain on the sale of that business of \$6.1 million. DFI was sold to a unit of Bingham Financial, Inc. in December 1999. We recognized a gain on the sale of that business of \$1.5 million. In the near term, Dynex will benefit from the reduction in general and administrative expenses as the result of the sales of those businesses; however, we will also lose the benefit of the net interest income on the assets that those businesses generated.

Throughout 1999, we continued to fund existing loan commitments in our commercial/multifamily lending area. In the fall of 1999, we decided not to extend approximately \$255 million of such loan commitments in order to conserve capital; however, by not extending, the Company recognized a \$28.4 million charge to its 1999 earnings related to deferred hedging losses on those commitments. We also took a charge against our 1999 results of \$31.6 million related to losses or writedowns of various assets, primarily commercial and multifamily loans. These charges were due in part to our decision to sell those loans as whole loans, versus securitizing these loans. With the changes in the market place over the last 18 months, Dynex and other small specialty finance companies are unable to economically securitize such loans.

Another issue that had a negative impact on Dynex throughout 1999 and into this year is the Company's investment in approximately \$100 million of sub-prime auto securities and the related litigation with the company ("AutoBond") that issued those securities. The litigation related to whether Dynex was justified in suspending its funding arrangement with such company in February 1999 as a result of findings primarily related to various compliance reviews on the underlying auto loans. Recently, this case went to trial in Travis County, Texas, where a jury found in favor of AutoBond. As of the date of this letter, the trial court has entered a judgment in favor of AutoBond of \$23.6 million, in lieu of the \$69.0 million verdict that the jury rendered earlier. Unless the parties reach a mediated settlement, the Company will likely appeal this judgment. The Company accrued \$31.7 million for AutoBond related exposure (including the litigation) in its 1999 results.

As a result of such losses and other factors, the Company is currently in violation of various covenants in many of its credit facilities. This affords such lenders the right to accelerate the related debt, although no such lender has done so as of the date hereof. These issues, coupled with the Company's difficulty in accessing new funding sources, led Dynex's auditors to issue what is commonly referred to as a "going concern" qualification to its audit opinion.

Outlook for 2000

We still have many challenges in front of us. It is uncertain as to whether Dynex could pay or post a bond against the \$23.6 million judgment against Dynex. Further, while we believe that our various secured lenders are well collateralized and we are making good progress in paying those lenders down primarily as a result of asset sales, it is uncertain whether any of those lenders will take action to accelerate their debt, which generally would cause the acceleration of all the Company's recourse debt. We also expect that certain asset sales will generate additional losses to the Company.

In addition, the recent rate increases by the Federal Reserve have reduced our net interest margin, primarily as a result of the timing lag between when our adjustable rate assets reset versus the reset of the cost of our borrowings. The net interest margin will also be negatively impacted by the decline in the Company's earning asset base, and higher borrowing costs in general. While we have reduced our general and administrative expenses dramatically since 1999, such reductions will not offset the erosion of net interest margin.

Future Direction

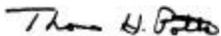
Many shareholders have inquired as to the future direction and plans for the Company. Our focus over the past year has been to conserve capital and pay down recourse debt. During 1999, we were successful in paying down over \$496 million in recourse debt, and we have paid down an additional \$116 million since the beginning of this year. In the near term, we will continue our focus on paying down recourse debt and other credit arrangements.

Furthermore, the Board of Directors has been seriously considering a possible merger, acquisition or liquidation of the Company, trying to weigh the possible short term benefit to shareholders of those options versus the possible longer term benefit to shareholders should the Company independently work through its current challenges. The Board of Directors will continue to evaluate the various avenues for the Company in an effort to improve shareholder value over either the short or longer term.

In Conclusion

Since the fall of 1998, our results reflect the dramatic impact on most specialty finance companies of changes in the fixed income markets, compounded in our case by the ill fated business relationship with AutoBond. Our results in 2000 will continue to suffer primarily as the result of asset sales to paydown lenders. Management will remain focused on managing through the current difficulties, in seeking to rebuild shareholder value.

Sincerely,



Thomas H. Potts
President

April 28, 2000

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 1999

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 1-9819

DYNEX CAPITAL, INC.

(Exact name of registrant as specified in its charter)

Virginia

52-1549373

(State or other jurisdiction of incorporation or organization)

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

10900 Nuckols Road, 3rd Floor, Glen Allen, Virginia

23060

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: **(804) 217-5800**

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$.01 par value	New York Stock Exchange

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Series A 9.75% Cumulative Convertible Preferred Stock, \$.01 par value	Nasdaq National Market
Series B 9.55% Cumulative Convertible Preferred Stock, \$.01 par value	Nasdaq National Market
Series C 9.73% Cumulative Convertible Preferred Stock, \$.01 par value	Nasdaq National Market

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 XX

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

As of March 31, 2000, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$64,373,558 (11,444,188 shares at a closing price on The New York Stock Exchange of \$5.625). Common stock outstanding as of March 31, 2000 was 11,444,188 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days from December 31, 1999, are incorporated by reference into Part III.

DYNEX CAPITAL, INC.
1999 FORM 10-K ANNUAL REPORT

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Item 1. BUSINESS

GENERAL

Dynex Capital, Inc. (the “Company”) was incorporated in the Commonwealth of Virginia in 1987. The Company is a financial services company which invests in a portfolio of securities and investments backed principally by single family mortgage loans, commercial mortgage loans and manufactured housing installment loans. Such loans have been funded generally by the Company’s loan production operations or purchased in bulk in the market. The Company’s primary loan production operations have included commercial mortgage lending, single family mortgage lending (which was sold in 1996) and manufactured housing lending (which was sold in 1999). Through its specialty finance business, the Company also has provided for the purchase and leaseback of single family model homes to builders (which was sold in 1999) and the purchase and management of delinquent property tax receivables. Loans funded through the Company’s production operations have generally been pooled and pledged (i.e. securitized) as collateral for non-recourse bonds (“collateralized bonds”), which provides long-term financing for such loans while limiting credit, interest rate and liquidity risk.

The Company’s principal source of earnings is net interest income from its investment portfolio. The Company’s investment portfolio consists primarily of collateral for collateralized bonds, asset-backed securities and loans held for sale or securitization. The Company funds its investment portfolio with both borrowings and funds raised from the issuance of equity. For the portion of the investment portfolio funded with borrowings, the Company generates net interest income to the extent that there is a positive spread between the yield on the interest-earning assets and the cost of borrowed funds. The cost of the Company’s borrowings may be increased or decreased by interest rate swap, cap or floor agreements. For the other portion of the investment portfolio funded with equity, net interest income is primarily a function of the yield generated from the interest-earning asset.

References to “Dynex REIT” mean the parent company and its wholly-owned subsidiaries, consolidated for financial reporting purposes, while references to the “Company” mean the parent company, its wholly-owned subsidiaries and Dynex Holding, Inc. (“DHI”) and its subsidiaries, which are not consolidated for financial reporting or tax purposes. All of the outstanding non-voting preferred stock (which represents a 99% economic interest in DHI) is owned by Dynex REIT. All of the outstanding voting common stock (which represents a 1% economic interest in DHI) is owned by certain senior officers of Dynex REIT. In light of these factors, DHI is accounted for under a method similar to the equity method. Dynex REIT has elected to be treated as a real estate investment trust (“REIT”) for federal income tax purposes under the Internal Revenue Code of 1986, as amended, and, as such, must distribute substantially all of its taxable income to shareholders and will generally not be subject to federal income tax.

During 1999, as a result of the difficult market environment for specialty finance companies such as the Company, the Company sold both its manufactured housing lending operations and model home purchase/leaseback business. Additionally, to conserve capital and to minimize its recourse borrowings, the Company decided in the fourth quarter of 1999 not to extend approximately \$255.6 million of forward commitments to fund commercial mortgage loans and to sell versus securitize the commercial loans the Company held in inventory. This difficult market environment was a result of the disruption in the fixed income markets during the fourth quarter of 1998. As a result of such disruption, investors in fixed income securities generally demanded higher yields in order to purchase securities issued by such specialty finance companies. Additionally, the Company believes the ratings agencies imposed higher credit enhancement levels and other requirements on securitizations sponsored by specialty finance companies. The net result of such changes in the market (which appear to be permanent versus temporary at this time) reduced the Company’s ability to compete against larger finance companies, investment banks and depository institutions, which generally have not been penalized by investors or ratings agencies when issuing fixed income securities. In addition, interim lenders that provided short-term funding to support the accumulation of loans for securitization have generally reduced their credit lines to specialty finance companies and otherwise tightened terms. As a result of the decision not to extend the forward commitments on commercial mortgage loans and the related decision to sell (versus securitize) many of the commercial mortgage loans in inventory, the Company recorded a charge in the fourth quarter of 1999 of \$54.6 million.

As more fully described in Note 1 in the accompanying consolidated financial statements, the Company is currently subject to certain significant risks and uncertainties, including violations of covenants in credit facilities, litigation, and the lack of access to new sources of capital. Management’s plans concerning these risks and uncertainties are discussed in Note 1.

Business Focus and Strategy

The Company strives to create a diversified investment portfolio that in the aggregate generates stable income for the Company in a variety of interest rate environments and preserves the capital base of the Company. The Company historically focused on markets where it believed that it could generate investments for its portfolio at a lower cost than if these investments were purchased in the secondary market. Over the past five years, the markets that the Company has participated in have included single family mortgage lending, commercial mortgage lending, manufactured housing lending, and various specialty finance businesses, including purchase/leaseback of model homes and the purchase and collection of delinquent property tax receivables. As previously indicated, the Company sold its single family lending business in 1996, and its manufactured housing lending operations and its purchase/leaseback model home business in 1999. As a result of these sales and the decision not to extend the forward commitments on commercial mortgage loans, the Company expects very limited direct fundings in the foreseeable future.

The Company has sought to generate growth in earnings and dividends per share in a variety of ways, including (i) adding investments to its portfolio when opportunities in the market are favorable; (ii) developing production capabilities to originate and acquire financial assets in order to create attractively priced investments for its portfolio, as well as control the underwriting and servicing of these assets; and (iii) increasing the efficiency with which the Company utilizes its equity capital over time. To increase potential returns to shareholders, the Company has employed leverage through the use of secured borrowings and repurchase agreements to fund a portion of its investment portfolio.

Prior Lending Operations

The Company generally has been a vertically integrated lender by performing the sourcing, underwriting, funding and servicing of loans to maximize efficiency and provide superior customer service. The Company generally has focused on loan products that maximize the advantages of the REIT tax election and has emphasized direct relationships with the borrower and minimized, to the extent practical, the use of origination intermediaries. The Company has historically utilized internally generated guidelines to underwrite loans for all product types and maintained centralized loan pricing, and performed the servicing function for loans on which the Company has credit exposure.

The following table summarizes the loan production activity for the three years ended December 31, 1999, 1998 and 1997.

Loan Production Activity (\$ in thousands)

	For the Years Ended December 31		
	1999	1998	1997
Commercial (1)	\$ 224,264	\$ 674,086	\$ 290,988
Manufactured housing	494,081	482,979	265,906
Specialty finance	140,763	196,224	168,965
Total fundings through direct production	859,108	1,353,289	725,859
Secured funding notes (2)	13,654	149,189	-
Securities acquired through bond calls	224	455,714	493,152
Single family fundings through bulk purchases	-	562,045	1,271,479
Total fundings	\$ 872,986	\$ 2,520,237	\$ 2,490,490
Principal amount of loans and securities securitized or sold	\$ 738,711	\$ 1,891,075	\$ 2,278,633

(1) Included in commercial fundings were \$136.7 million, \$228.6 million, and \$49.2 million of multifamily construction loans closed during years ended December 31, 1999, 1998 and 1997, respectively. As of December 31, 1999, \$414.5 million of multifamily construction loans have closed, of which only the amount drawn for these loans of \$115.5 million is included in the balance of the loans held for sale or securitization at December 31, 1999.

(2) Secured by automobile installment contracts

During 1999, the Company funded \$224.3 million of commercial loans consisting of \$136.7 million of construction loans, \$57.3 million of multifamily loans and \$30.3 million in other types of commercial loans. The majority of the

multifamily loans funded in 1999 consist of mortgage loans on properties that have been allocated low income housing tax credits. As of March 31, 2000, commitments to fund commercial loans were approximately \$26.0 million.

Prior to the sale of the manufactured housing lending operations to Bingham Financial Services Corporation (“Bingham”) (NASDAQ: BSFC) in December 1999, the Company funded \$494.1 million of manufactured housing loans during 1999. The Company sold \$77.3 million of such loans to Bingham as part of the sale transaction. The Company securitized a total of \$601.8 million of its manufactured housing loans (including current and prior years’ production) through the issuance of collateralized bonds during 1999.

At December 31, 1999, the Company owned the right to call \$353.9 million of securities previously issued by the Company once the outstanding balance of such securities reaches 10% or less of the original amount issued.

The Company did not purchase any loans on a bulk basis in 1999, compared to \$562.0 million of single family adjustable-rate (“ARM”) loans bulk purchased in 1998. All of the single family ARM loans purchased in 1998 were securitized through the issuance of collateralized bonds.

During June 1998, the Company entered into a series of agreements with AutoBond Acceptance Corporation (“AutoBond”) (OTC: AUBD) to purchase “funding notes” secured by automobile contracts originated by AutoBond. The gross amount of funding notes purchased by the Company was \$162.8 million. In February 1999, the Company suspended purchasing the funding notes as a result of the findings of compliance reviews done by third parties and other breaches of the agreements. As a result, AutoBond and related entities sued the Company in the district court of Travis County, Texas. On March 9, 2000, a jury entered a verdict in favor of AutoBond in an amount approximating \$69 million. On April 17, 2000, based on motions filed by the Company, the judge presiding over the matter in Travis County proposed a judgement of approximately \$27 million (which includes estimated prejudgment interest), in lieu of the approximate \$69 million jury verdict. As a result, the Company recorded a litigation provision of \$27.0 million effective for the year ended December 31, 1999. See *Item 3. Legal Proceedings*.

Asset Servicing

As mentioned above, the Company’s philosophy is generally to service assets that it has originated due to the retention of a portion of the credit risk on that asset. The Company established the capability to service both commercial and manufactured housing loans funded through its production operations in 1996. The manufactured housing servicing operations, and the associated \$1.1 billion servicing portfolio, were sold in December 1999. The Company has retained credit risk on these loans through overcollateralization of approximately \$110 million. As of December 31, 1999, the 60-plus day delinquencies on these \$1.1 billion of loans was 1.42%. As of December 31, 1999, the Company had a commercial servicing portfolio totaling \$1.2 billion. There were no delinquencies in the commercial loan servicing portfolio as of December 31, 1999. The Company may sell its commercial loan servicing portfolio during 2000.

During 1997, the Company established a servicing function in Pittsburgh, Pennsylvania, to manage the collection of the Company’s delinquent property tax receivables. The Company’s responsibilities as servicer include contacting property owners, collecting voluntary payments, and foreclosing, rehabilitating and selling remaining properties if collection efforts fail. During 1999, the Company also established a satellite servicing office in Cleveland, Ohio. As of December 31, 1999, the Company had a servicing portfolio of \$84.6 million of property tax receivables in seven states.

Securitization

The Company historically has used funds provided by its senior notes, bank borrowings, repurchase agreements and equity to finance loan production when loans are initially funded. When a sufficient volume of loans was accumulated, generally between \$300 million and \$1 billion in principal amount, the loans were securitized through the issuance of mortgage or asset-backed securities in the form of collateralized bonds. The length of time between when the Company committed to fund the loan and when it securitized the loan varied depending on certain factors, including the length of the loan commitment (the Company has committed to fund various commercial and multifamily loans on a forward-basis), the loan volume by product type, market forces (e.g., whether there exists in the market place sufficient purchasers of these types of mortgage or asset-backed securities), and variations in the securitization process. In adverse market conditions, the Company may be unable to securitize the loans. Though the Company utilizes primarily committed facilities to finance its loan production prior to securitization, in adverse market conditions, the Company may have to sell loans at losses in order to repay these facilities. In the current environment, the Company is unable to economically securitize commercial mortgage loans. As a result, commercial mortgage loans remaining in the Company’s inventory as of December 31, 1999 are now considered held for sale.

Since late 1995, the Company's predominate securitization structure has been collateralized bonds. Generally, for accounting and tax purposes, the loans and securities financed through the issuance of collateralized bonds are treated as assets of the Company, and the collateralized bonds are treated as debt of the Company. The Company earns the net interest spread between the interest income on the securities and the interest and other expenses associated with the collateralized bond financing. The net interest spread is directly impacted by the levels of prepayments of the underlying mortgage loans and, to the extent collateralized bond classes are variable-rate, may be affected by changes in short-term rates. The Company retains an investment in the collateralized bonds, typically referred to as the overcollateralization.

Master Servicing

The Company performs the function of master servicer for certain of the securities it has issued. The master servicer's function typically includes monitoring and reconciling the loan payments remitted by the servicers of the loans, determining the payments due on the securities and determining that the funds are correctly sent to a trustee or investors for each series of securities. Master servicing responsibilities also include monitoring the servicers' compliance with its servicing guidelines. As master servicer, the Company is paid a monthly fee based on the outstanding principal balance of each such loan master serviced or serviced by the Company as of the last day of each month. As of December 31, 1999, the Company master serviced \$3.0 billion in securities.

Investment Portfolio

The core of the Company's earnings is derived from its investment portfolio. The Company's strategy for its investment portfolio is to create a diversified portfolio of high quality assets that in the aggregate generates stable income in a variety of interest rate and prepayment environments and preserves the Company's capital base. In many instances, the investment strategy involves not only the creation of the asset, but also structuring the related securitization or borrowing to create a stable yield profile and reduce interest rate and credit risk.

The Company continuously monitors the aggregate cash flow, projected net yield and market value of its investment portfolio under various interest rate and prepayment environments. While certain investments may perform poorly in an increasing or decreasing interest rate environment, certain other investments may perform well, and others may not be impacted at all. Generally, the Company adds investments to its portfolio which are designed to increase the diversification and reduce the variability of the yield produced by the portfolio in different interest rate environments.

Credit Quality. Excluding certain securities where the risk is primarily the rate of prepayments and not credit, 90.0 % of the Company's investments relate to securities rated AA or AAA by at least one nationally-recognized rating agency. These ratings are based on AAA rated bond insurance, third-party guarantees, mortgage pool insurance or subordination. On securities where the Company has retained a portion of the credit risk below the investment grade level (BBB), the Company's exposure to credit losses below the investment grade level was \$229.3 million as of December 31, 1999. This credit exposure is reduced by reserves, discounts and third party guarantees of \$49.9 million.

Composition. The following table presents the balance sheet composition of the investment portfolio at fair market value by investment type and the percentage of the total investments as of December 31, 1999 and 1998.

<i>(amounts in thousands)</i>	As of December 31,			
	1999		1998	
	Balance	% of Total	Balance	% of Total
Investments:				
Collateral for collateralized bonds	\$ 3,700,714	90.0%	\$ 4,293,528	86.6%
Securities:				
Funding Notes and Securities	95,027	2.3	122,009	2.5
Adjustable-rate mortgage securities	11,410	0.3	47,728	1.0
Fixed-rate mortgage securities	9,623	0.2	28,981	0.6
Derivative and residual securities	11,651	0.3	18,894	0.4
Other securities	-	-	26,372	0.5
Other investments	48,927	1.2	30,371	0.6
Loans held for sale or securitization	232,384	5.7	388,782	7.8
Total investments	\$ 4,109,736	100%	\$ 4,956,665	100%

Collateral for collateralized bonds. Collateral for collateralized bonds represents the single largest investment in the Company's portfolio. Collateral for collateralized bonds is composed primarily of securities backed primarily by adjustable-rate and fixed-rate mortgage loans secured by first liens on single family homes, fixed-rate mortgage loans secured by multifamily residential housing properties and commercial properties, manufactured housing installment loans secured by either a UCC filing or a motor vehicle title, and property tax receivables. Interest margin on the net investment in collateralized bonds (defined as the principal balance of collateral for collateralized bonds less the principal balance of the collateralized bonds outstanding) is derived primarily from the difference between (i) the cash flow generated from the collateral pledged to secure the collateralized bonds and (ii) the amounts required for payment on the collateralized bonds and related insurance and administrative expenses. Collateralized bonds are generally non-recourse to the Company. The Company's yield on its net investment in collateralized bonds is affected primarily by changes in interest rates and prepayment rates and credit losses on the underlying loans. The Company may retain for its investment portfolio certain classes of the collateralized bonds issued and pledge such classes as collateral for repurchase agreements.

Funding Notes and Securities. Funding Notes and Securities consist of fixed-rate securities secured by fixed-rate automobile installment contracts made to borrowers with limited access to traditional sources of credit. Such Funding Notes and Securities were purchased from limited purpose subsidiaries of AutoBond. The Funding Notes and Securities are carried at their estimated net realizable value.

ARM securities. Another segment of the Company's portfolio is the investments in ARM securities. The interest rates on the majority of the Company's ARM securities reset every six months and the rates are subject to both periodic and lifetime limitations. Generally, the Company finances a portion of its ARM securities with repurchase agreements, which have a fixed rate of interest over a term that ranges from 30 to 90 days and, therefore, are not subject to repricing limitations. As a result, the net interest margin on the ARM securities could decline if the spread between the yield on the ARM security versus the interest rate on the repurchase agreement was reduced.

Fixed-rate mortgage securities. Fixed-rate mortgage securities consist of securities that have a fixed-rate of interest for specified periods of time. The Company's yields on these securities are primarily affected by changes in prepayment rates. Such yields will decline with an increase in prepayment rates and will increase with a decrease in prepayment rates. The Company generally borrows against its fixed-rate mortgage securities through the use of repurchase agreements. Additionally, the net interest margin the Company realizes on its fixed-rate mortgage securities will be subject to the spread between the yield on the fixed-rate mortgage securities and the effective interest rate on the repurchase agreements. The effective interest rates on the repurchase agreements generally resets within 30-day intervals.

Derivative and residual securities. Derivative and residual securities consist primarily of interest-only securities ("I/Os"), principal-only securities ("P/Os") and residual interests which were either purchased or were created through the Company's production operations. An I/O is a class of a collateralized bond or a mortgage pass-through security that pays to the holder substantially all interest. A P/O is a class of a collateralized bond or a mortgage pass-through security that pays to the holder substantially all principal. Residual interests represent the excess cash flows on a pool of mortgage collateral after payment of principal, interest and expenses of the related mortgage-backed security or repurchase arrangement. Residual interests may have little or no principal amount and may not receive scheduled interest payments. Included in the residual interests at December 31, 1999 was \$8.6 million of equity ownership in residual trusts which own collateral financed with repurchase agreements, which had a fair value of \$2.8 million. The Company's borrowings against its derivative and residual securities is limited by certain loan covenants to 3% of shareholders' equity. The yields on these securities are affected primarily by changes in prepayment rates and by changes in short-term interest rates.

Other securities. Other securities consisted primarily of a corporate bond at December 31, 1998.

Other investments. Other investments consists primarily of an installment note receivable received in connection with the sale of the Company's single family mortgage operations in May 1996, and property tax receivables.

Loans held for sale or securitization. As of December 31, 1999, all loans are held for sale and consist principally of multifamily permanent and construction mortgage loans. Since these loans are held for sale, the loans are carried at the lower of cost or market. Loans as of December 31, 1998 consisted principally of multifamily permanent and construction mortgage loans, commercial mortgage loans and manufactured housing loans. These loans were primarily held for securitization as of that date.

Investment Portfolio Risks

The Company is exposed to several types of risks inherent in its investment portfolio. These risks include credit risk (inherent in the loans before securitization and the security structure after securitization), prepayment/interest rate risk (inherent in the underlying loan) and margin call risk (inherent in the security if it is used as collateral for recourse borrowings).

Credit Risk. Credit risk is the risk of loss to the Company from the failure by a borrower (or the proceeds from the liquidation of the underlying collateral) to fully repay the principal balance and interest due on a loan. A borrower's ability to repay, or the value of the underlying collateral, could be negatively influenced by economic and market conditions. These conditions could be global, national, regional or local in nature. When a loan is funded and becomes part of the Company's investment portfolio, the Company has all of the credit risk on the loan should it default. Upon securitization of the pool of loans, the credit risk retained by the Company is generally limited to the net investment in collateralized bonds and subordinated securities. The Company provides for reserves for expected losses based on the current performance of the respective pool of loans; however, if losses are experienced more rapidly due to market conditions than the Company has provided for in its reserves, the Company may be required to provide for additional reserves for these losses.

The Company began to retain a portion of the credit risk on securitized mortgage loans in 1994 as mortgage pool insurance became less available in the market and as the Company diversified into other products. The Company evaluates and monitors its exposure to credit losses and has established reserves and discounts for probable credit losses based upon anticipated future losses on the loans, general economic conditions and historical trends in the portfolio. As of December 31, 1999, the Company's credit exposure on securities rated below investment grade or as to overcollateralization was \$229.3 million. This amount excludes funding notes and securities which are carried at estimated net realizable value, other investments and loans held for sale or securitization which are carried at the lower of cost or market. This amount is reduced by on-balance sheet reserves and discounts of \$19.6 million, and third party guarantees of \$30.3 million.

Prepayment/Interest Rate Risk. The interest rate environment may also impact the Company. For example, in a rising rate environment, the Company's net interest margin may be reduced, as the interest cost for its funding sources (collateralized bonds, repurchase agreements, and committed lines of credit) could increase more rapidly than the interest earned on the associated asset financed. The Company's funding sources are substantially based on the one-month London InterBank Offered Rate ("LIBOR") and reprice monthly, while the associated assets are principally six-month LIBOR or one-year Constant Maturity Treasury ("CMT") based and generally reprice every six-to-twelve months. In a declining rate environment, net interest margin may be enhanced for the opposite reasons. However, in a period of declining interest rates, loans in the investment portfolio will generally prepay more rapidly (to the extent that such loans are not prohibited from prepayment), which may result in additional amortization expense of asset premium. In a flat yield curve environment (i.e., when the spread between the yield on the one-year Treasury and the yield on the ten-year Treasury is less than 1.0%), single-family ARM loans tend to rapidly prepay, causing additional amortization of asset premium. In addition, the spread between the Company's funding costs and asset yields would most likely compress, causing a further reduction in the Company's net interest margin. Lastly, the Company's investment portfolio may shrink, or proceeds returned from prepaid assets may be invested in lower yielding assets. The severity of the impact of a flat yield curve to the Company would depend on the length of time the yield curve remained flat.

The Company strives to structure its investment portfolio to provide stable spread income in a variety of prepayment and interest rate scenarios. To manage prepayment risk (i.e. from a decline in long-term rates on fixed rate assets, or a flattening or inverse yield curve as to ARM assets), the Company minimizes the amount of "interest-only" investments or premium on assets. The Company has, in aggregate, \$30.2 million of asset premium relating to assets with prepayment lockouts or yield maintenance provision for at least seven years, and \$3.9 million of asset premium on its remaining assets. In addition, future earnings may be lower as a result of the reduction in the interest-earning assets from increased prepayment speeds or if the Company is otherwise unable to invest in new assets.

The Company also views its hedging activities as a tool to manage interest rate risk. As mentioned previously, the Company finances its adjustable-rate assets, which primarily reprice typically every six months based on six-month LIBOR and one-year CMT and typically are limited to an interest rate adjustment of 1% increase every six months or a 2% increase every twelve months, with borrowings that reprice monthly indexed to one-month LIBOR and have no periodic caps. To manage the periodic interest rate risk associated with the Company's borrowings to the extent that interest rates rise more than 1% in a six-month period, the Company has entered into an interest rate swap agreement that has effectively capped the increase in the borrowing costs on \$1.02 billion of borrowings to 1% during any six-month period. The terms of the swap are such that the Company pays the lesser of current six-month LIBOR, or six-month LIBOR, in effect 180 days prior plus 1%,

and receives current six-month LIBOR. As this is an interest rate swap agreement, the Company recognizes the net additional interest income or expense from the interest rate swap as an adjustment to interest expense recognized on the borrowings. This swap agreement expires in 2001. As the adjustable-rate assets also have lifetime interest rate caps, the Company has \$1.4 billion in interest rate cap agreements (with contracted rates between 9.0% and 11.5% based on six-month LIBOR and one-year CMT) to provide the Company with additional cash flow should short-term rates rise significantly. These cap agreements expire from 2001 to 2004.

Margin Call Risk. The Company uses repurchase agreements to finance a portion of its investment portfolio. Margin call risk is the risk that the Company will be required to provide additional collateral to the counterparties of its secured recourse borrowings should the value of the asset pledged as collateral for the recourse borrowings decline. Generally, the Company pledges only investment grade rated securities or whole loans as collateral for recourse borrowings. The value of the pledged security or loan is impacted by a variety of factors, including the perceived credit risk of the security or loan, the type and performance of the underlying loans in the security, current market volatility, and the general amount of liquidity in the market place for the asset financed. In instances where market volatility is high, there are credit issues on the collateral, or where overall liquidity in the market has been reduced, the Company may experience margin calls from its lenders. Depending on the Company's current liquidity position, the Company may be forced to sell assets to meet margin calls, which may result in losses. The Company attempts to manage its margin call risk, and thereby limit its liquidity risk, by limiting the amount of its recourse borrowings to less than 2.5 times equity. As of December 31, 1999, the Company had repurchase agreements outstanding of \$163.0 million. As of March 31, 2000, the Company had reduced the repurchase agreements outstanding to approximately \$81.0 million.

The Company also has liquidity risk inherent to its investment in certain residual trusts. These trusts are subject to margin calls and the Company, at its option, may provide additional equity to the trust to meet the margin call. Should the Company not provide the additional equity, the assets of the trust could be sold to meet the trusts' obligations, resulting in a potential loss to the Company. At December 31, 1999, the total amount of such investments was \$8.6 million.

Since 1996, the Company has structured all of its securitizations as non-recourse collateralized bonds, with the financing, in effect, incorporated into the bond structure. This structure eliminates the need for repurchase agreements on such collateral, and consequently eliminates the margin call risk and to a lesser degree the interest rate risk. During 1999, 1998 and 1997, the Company issued approximately \$2.1 billion, \$2.0 billion and \$2.6 billion, respectively, in collateralized bonds. To the extent the Company were to issue securities in the future, the Company plans to continue to use collateralized bonds as its primary securitization vehicle.

FEDERAL INCOME TAX CONSIDERATIONS

General

Dynex REIT believes it has complied and, intends to comply in the future, with the requirements for qualification as a REIT under the Internal Revenue Code (the Code). To the extent that Dynex REIT qualifies as a REIT for federal income tax purposes, it generally will not be subject to federal income tax on the amount of its income or gain that is distributed to shareholders. DHI and its subsidiaries, which conduct the production operations, are not qualified REIT subsidiaries and are not consolidated with Dynex REIT for either tax or financial reporting purposes. Consequently, the taxable income of DHI and its subsidiaries is subject to federal and state income taxes. Dynex REIT will include in taxable income amounts earned by DHI only when DHI remits its after-tax earnings in the form of a dividend to Dynex REIT.

The REIT rules generally require that a REIT invest primarily in real estate-related assets, that its activities be passive rather than active and that it distribute annually to its shareholders substantially all of its taxable income. Dynex REIT could be subject to income tax if it failed to satisfy those requirements or if it acquired certain types of income-producing real property. Although no complete assurances can be given, Dynex REIT does not expect that it will be subject to material amounts of such taxes.

Failure to satisfy certain Code requirements could cause Dynex REIT to lose its status as a REIT. If Dynex REIT failed to qualify as a REIT for any taxable year, it would be subject to federal income tax (including any applicable alternative minimum tax) at regular corporate rates and would not receive deductions for dividends paid to shareholders. As a result, the amount of after-tax earnings available for distribution to shareholders would decrease substantially. While the Board of Directors intends to cause Dynex REIT to operate in a manner that will enable it to qualify as a REIT in future taxable years, there can be no certainty that such intention will be realized.

In December 1999, with an effective date of January 1, 2001, Congress signed into law several changes to the provisions of the Code relating to REITs. The most significant of these changes relates to the reduction of the distribution requirement from 95% to 90% of taxable income and the allowance of REITs to own 100% interest in its taxable REIT subsidiaries.

Qualification of the Company as a REIT

Qualification as a REIT requires that Dynex REIT satisfy a variety of tests relating to its income, assets, distributions and ownership. The significant tests are summarized below.

Sources of Income. To continue qualifying as a REIT, Dynex REIT must satisfy two distinct tests with respect to the sources of its income: the “75% income test” and the “95% income test”. The 75% income test requires that Dynex REIT derive at least 75% of its gross income (excluding gross income from prohibited transactions) from certain real estate-related sources. In order to satisfy the 95% income test, 95% Dynex REIT’s gross income for the taxable year must consist either of income that qualifies under the 75% income test or certain other types of passive income.

If Dynex REIT fails to meet either the 75% income test or the 95% income test, or both, in a taxable year, it might nonetheless continue to qualify as a REIT, if its failure was due to reasonable cause and not willful neglect and the nature and amounts of its items of gross income were properly disclosed to the Internal Revenue Service. However, in such a case Dynex REIT would be required to pay a tax equal to 100% of any excess non-qualifying income.

Nature and Diversification of Assets. At the end of each calendar quarter, three asset tests must be met by Dynex REIT. Under the 75% asset test, at least 75% of the value of Dynex REIT’s total assets must represent cash or cash items (including receivables), government securities or real estate assets. Under the “10% asset test”, Dynex REIT may not own more than 10% of the outstanding voting securities of any single non-governmental issuer, if such securities do not qualify under the 75% asset test. Under the “5% asset test,” ownership of any stocks or securities that do not qualify under the 75% asset test must be limited, in respect of any single non-governmental issuer, to an amount not greater than 5% of the value of the total assets of Dynex REIT.

If Dynex REIT inadvertently fails to satisfy one or more of the asset tests at the end of a calendar quarter, such failure would not cause it to lose its REIT status, provided that (i) it satisfied all of the asset tests at the close of a preceding calendar quarter and (ii) the discrepancy between the values of Dynex REIT’s assets and the standards imposed by the asset tests either did not exist immediately after the acquisition of any particular asset or was not wholly or partially caused by such an acquisition. If the condition described in clause (ii) of the preceding sentence was not satisfied, Dynex REIT still could avoid disqualification by eliminating any discrepancy within 30 days after the close of the calendar quarter in which it arose.

Distributions. With respect to each taxable year, in order to maintain its REIT status, Dynex REIT generally must distribute to its shareholders an amount at least equal to 95% of the sum of its “REIT taxable income” (determined without regard to the deduction for dividends paid and by excluding any net capital gain) and any after-tax net income from certain types of foreclosure property minus any “excess noncash income.” The Code provides that distributions relating to a particular year may be made in the following year, in certain circumstances. Dynex REIT will balance the benefit to the shareholders of making these distributions and maintaining REIT status against their impact on the liquidity of Dynex REIT. In an unlikely situation, it may benefit the shareholders if Dynex REIT retained cash to preserve liquidity and thereby lose REIT status. Effective January 1, 2001, the Code has reduced the distribution requirement from 95% of REIT taxable income to 90% of REIT taxable income.

Ownership. In order to maintain its REIT status, Dynex REIT must not be deemed to be closely held and must have more than 100 shareholders. The closely held prohibition requires that not more than 50% of the value of Dynex REIT’s outstanding shares be owned by five or fewer persons at anytime during the last half of Dynex REIT’s taxable year. The more than 100 shareholder rule requires that Dynex REIT have at least 100 shareholders for 335 days of a twelve-month taxable year. In the event that Dynex REIT failed to satisfy the ownership requirements Dynex REIT would be subject to fines and required to take curative action to meet the ownership requirements in order to maintain its REIT status.

For federal income tax purposes, Dynex REIT is required to recognize income on an accrual basis and to make distributions to its shareholders when income is recognized. Accordingly, it is possible that income could be recognized and distributions required to be made in advance of the actual receipt of such funds by Dynex REIT. The nature of Dynex REIT’s investments is such that it expects to have sufficient assets to meet federal income tax distribution requirements.

Taxation of Distributions by Dynex REIT

Assuming that Dynex REIT maintains its status as a REIT, any distributions that are properly designated as “capital gain dividends” will generally be taxed to shareholders as long-term or mid-term capital gains, regardless of how long a shareholder has owned his shares. Any other distributions out of Dynex REIT’s current or accumulated earnings and profits will be dividends taxable as ordinary income. Distributions in excess of Dynex REIT’s current or accumulated earnings and profits will be treated as tax-free returns of capital, to the extent of the shareholder’s basis in his shares and, as gain from the disposition of shares, to the extent they exceed such basis. Shareholders may not include on their own tax returns any of Dynex REIT ordinary or capital losses. Distributions to shareholders attributable to “excess inclusion income” of Dynex REIT will be characterized as excess inclusion income in the hands of the shareholders. Excess inclusion income can arise from Dynex REIT’s holdings of residual interests in real estate mortgage investment conduits and in certain other types of mortgage-backed security structures created after 1991. Excess inclusion income constitutes unrelated business taxable income (“UBTI”) for tax-exempt entities (including employee benefit plans and individual retirement accounts) and it may not be offset by current deductions or net operating loss carryovers. In the unlikely event that Dynex REIT’s excess inclusion income is greater than its taxable income, Dynex REIT’s distribution would be based on Dynex REIT’s excess inclusion income. Dividends paid by Dynex REIT to organizations that generally are exempt from federal income tax under Section 501(a) of the Code should not be taxable to them as UBTI except to the extent that (i) purchase of shares of Dynex REIT was financed by “acquisition indebtedness” or (ii) such dividends constitute excess inclusion income. In 1999, Dynex REIT’s excess inclusion income was de minimus.

Taxable Income

Dynex REIT uses the calendar year for both tax and financial reporting purposes. However, there may be differences between taxable income and income computed in accordance with GAAP. These differences primarily arise from timing differences in the recognition of revenue and expense for tax and GAAP purposes. Dynex REIT has not yet finalized the determination of its taxable income for the year ended December 31, 1999. However, the Company believes that it has met all of the REIT distribution requirements of the Code.

REGULATION

Prior to the sale of its manufactured housing lending operation, the Company was an approved mortgage and consumer loan originator and servicer, and therefore was subject to various federal and state regulations. A violation of such regulations while the Company owned such business may still result in a loss to the Company as a result of various representations and warranties made by the Company in regard to the sale of such business.

Such rules and regulations, among other things, prohibit discrimination and establish underwriting guidelines that include provisions for inspections and appraisals, require credit reports on prospective borrowers and fix maximum loan amounts. In particular, the Company was subject to, among other laws, the Equal Credit Opportunity Act, Federal Truth-in-Lending Act and the Real Estate Settlement Procedures Act and the regulations promulgated thereunder that prohibit discrimination and require the disclosure of certain basic information to mortgagors concerning credit terms and settlement costs. The Company’s servicing activities were also subject to, among other laws, the Fair Credit Reporting Act and the Fair Debt Collections Practices Act. The Company’s existing consumer-related servicing activities consist of collections on the delinquent property tax receivables. Such servicing operations are managed in compliance with the Fair Debt Collections Practices Act.

The Company believes that it is in material compliance with all material rules and regulations to which it is subject.

COMPETITION

The Company competes with a number of institutions with greater financial resources in originating and purchasing loans. In addition, in purchasing portfolio investments and in issuing securities, the Company competes with investment banking firms, savings and loan associations, commercial banks, mortgage bankers, insurance companies and federal agencies and other entities purchasing mortgage assets, many of which have greater financial resources than the Company.

EMPLOYEES

As of December 31, 1999, Dynex REIT had 31 employees and DHI had 65 employees.

Item 2. PROPERTIES

The Company's executive and administrative offices and operations offices are both located in Glen Allen, Virginia, on properties leased by the Company which consist of approximately 32,000 square feet. The address is 10900 Nuckols Road, 3rd Floor, Glen Allen, Virginia 23060. The lease expires in 2003. DHI and subsidiaries also occupy space located in Glen Allen, Virginia; Shrewesberry, New Jersey; Cleveland, Ohio; Pittsburgh, Pennsylvania; and Versailles, Pennsylvania. These locations consist of approximately 14,250 square feet, and the leases associated with these properties, if any, expire in 2000 through 2001.

Item 3. LEGAL PROCEEDINGS

On February 8, 1999, AutoBond Acceptance Corporation ("AutoBond"), AutoBond Master Funding Corporation V ("Funding"), and its three principal common shareholders (collectively, the "Plaintiffs") commenced an action in the District Court of Travis County, Texas (250th Judicial District) against the Company and James Dolph (collectively, the "Defendants") alleging that the Company breached the terms of the Credit Agreement, dated June 9, 1998, by and among AutoBond, Funding and the Company. The terms of the Credit Agreement provided for the purchase by the Company of funding notes issued by Funding, and collateralized by automobile installment contracts ("Auto Contracts") acquired by AutoBond. The Company suspended purchasing the funding notes in February 1999 on grounds that AutoBond and Funding had violated certain provisions of the Credit Agreement. The Plaintiffs also alleged that the Defendants conspired to misrepresent and mischaracterize AutoBond's credit underwriting criteria and its compliance with such criteria with the intention of interfering and causing actual damage to AutoBond's business, prospective business and contracts.

On August 26, 1999, the District Court of Travis County ordered AutoBond and Funding, through a temporary injunction action, to cooperate with the Company and permit the transfer of the servicing of the Auto Contracts from AutoBond to a third party servicer selected by the Company. The servicing was transferred on September 3, 1999.

On March 9, 2000, a jury in the AutoBond action returned a verdict in favor of the Plaintiffs, and awarded AutoBond and Funding \$18.7 million in direct lost profits and \$50.5 million in lost future profits, for a total of \$69.2 million. The Company filed on March 24, 2000 with the Court motions to set aside the verdict and to reduce the amount of the verdict, and on the same date, AutoBond filed a motion to the court to enter judgment. On April 17, 2000, in response to the various motions filed, the judge presiding over the matter in Travis County reduced the \$69.2 million verdict awarded by the jury to approximately \$27 million (which includes estimated prejudgment interest). As a result, the Company recorded a litigation provision of \$27.0 million for the amount of the reduced judgment. Should AutoBond not accept the proposed judgment, the judge has indicated that he will grant Dynex a new trial. Should AutoBond accept the judgment, the Company is evaluating its options in the matter, which may include the appeal of the verdict and the resulting judgment. Factors for the Company to consider include the potential inability of the Company to post the amount of appeal bond necessary to secure an appeal. Should Dynex REIT not be able to secure an appeal bond for the full amount of the proposed judgement of \$27 million, Texas State law would allow for Dynex REIT to present evidence to reduce the required amount of the appeal bond or to provide other collateral for the appeal. There can be no assurance that Dynex REIT will be allowed to post a reduced bond.

The Company is also subject to other lawsuits or claims which arise in the ordinary course of its business, some of which seek damages in amounts which could be material to the financial statements. Although no assurance can be given with respect to the ultimate outcome of any such litigation or claim, the Company believes the resolution of such lawsuits or claims will not have a material affect on the Company's consolidated balance sheet, but could materially affect consolidated results of operations in a given year.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Dynex Capital, Inc.'s common stock is traded on the New York Stock Exchange under the trading symbol DX. The common stock was held by approximately 3,663 holders of record as of February 29, 2000. During the last two years, the high and low closing stock prices and cash dividends declared on common stock, adjusted for the two-for-one stock split effective May 5, 1997 and the one-for-four reverse stock split effective August 2, 1999, were as follows:

	High	Low	Cash Dividends Declared
1999:			
First quarter	\$ 22	\$ 11	\$ -
Second quarter	16	8 1/4	-
Third quarter	13 3/16	5 1/2	-
Fourth quarter	8 5/8	6	-
1998:			
First quarter	\$ 54 1/2	\$ 47 3/4	\$1.20
Second quarter	49 1/2	39 3/4	1.20
Third quarter	46	32 1/2	1.00
Fourth quarter	32 1/2	17 1/4	-

Item 6. SELECTED FINANCIAL DATA*(amounts in thousands except share data)*

Years ended December 31,	1999	1998	1997	1996	1995
Net interest margin	\$ 48,015	\$ 66,538	\$ 83,454	\$ 73,750	\$ 41,778
Write-downs associated with commercial production operations	(59,962)	-	-	-	-
(Loss) gain on sale of investments and trading activities	(12,682)	(2,714)	11,584	(385)	(7,060)
Gain on sale of loan production operations	7,676	-	-	21,512	-
Impairment charge and litigation provision - AutoBond	(31,732)	(17,632)	-	-	-
Equity in net (loss) earnings of Dynex Holding, Inc.	(1,923)	2,456	(1,109)	(4,309)	11,600
Other income	1,673	2,852	1,716	606	294
General and administrative expenses	(7,740)	(8,973)	(9,531)	(8,365)	(5,036)
Net administrative fees and expenses to Dynex Holding, Inc.	(16,943)	(22,379)	(12,116)	(9,761)	(4,666)
Extraordinary item - loss on extinguishment of debt	(1,517)	(571)	-	-	-
Net (loss) income	\$ (75,135)	\$ 19,577	\$ 73,998	\$ 73,048	\$ 36,910
Total revenue	\$ 350,798	\$ 410,821	\$ 346,859	\$ 333,029	\$ 250,830
Total expenses	\$ 425,933	\$ 391,244	\$ 272,861	\$ 259,981	\$ 213,920
Income per common share before extraordinary item:					
Basic (1)	\$ (7.53)	\$ 0.62	\$ 5.50	\$ 6.17	\$ 3.40
Diluted (1)	(7.53)	0.62	5.48	5.94	3.40
Net income per common share after extraordinary item:					
Basic (1)	\$ (7.67)	\$ 0.57	\$ 5.50	\$ 6.17	\$ 3.40
Diluted (1)	(7.67)	0.57	5.48	5.94	3.40
Dividends declared per share:					
Common (1)	\$ -	\$ 3.40	\$ 5.42	\$ 4.532	\$ 3.36
Series A Preferred	1.17	2.37	2.71	2.375	1.17
Series B Preferred	1.17	2.37	2.71	2.375	0.42
Series C Preferred	1.46	2.92	2.92	0.600	-
Return on average common shareholders' equity (2)	(27.3%)	2.0%	17.9%	21.6%	12.5%
Total fundings	\$ 872,986	\$2,520,237	\$2,490,490	\$1,508,780	\$ 916,570

December 31,	1999	1998	1997	1996	1995
Investments (3)	\$4,109,736	\$4,956,665	\$5,211,009	\$3,918,989	\$3,421,470
Total assets	4,190,896	5,178,848	5,367,413	3,980,820	3,482,702
Non-recourse debt	3,282,378	3,665,316	3,632,079	2,149,068	843,856
Recourse debt	537,098	1,032,733	1,133,536	1,294,972	2,237,571
Total liabilities	3,865,824	4,726,044	4,806,504	3,477,203	3,127,879
Shareholders' equity	325,072	452,804	560,909	503,617	354,823
Number of common shares outstanding	11,444,099	46,027,426	45,146,242	20,653,593	20,198,654
Average number of common shares (1)	11,483,977	11,436,599	10,757,845	10,222,395	10,061,386
Book value per common share (1)	\$ 16.74	\$ 27.75	\$ 37.59	\$ 34.60	\$ 26.11

*(1) Adjusted for two-for-one common stock split effective May 5, 1997 and the one-for-four reverse common stock split effective August 2, 1999.**(2) Excludes unrealized gain/loss on investments available-for-sale.**(3) Investments classified as available for sale are shown at fair value.*

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

The Company is a financial services company which invests in a portfolio of securities and investments backed principally by single family mortgage loans, commercial mortgage loans and manufactured housing installment loans. Such loans have been funded generally by the Company's loan production operations or purchased in bulk in the market. Loans funded through the Company's production operations have generally been pooled and pledged as collateral using a collateralized bond security structure, which provides long-term financing for the loans while limiting credit, interest rate and liquidity risk.

FINANCIAL CONDITION

<i>(amounts in thousands except per share data)</i>	December 31,	
	1999	1998
Investments:		
Collateral for collateralized bonds	\$ 3,700,714	\$ 4,293,528
Securities	127,711	243,984
Other investments	48,927	30,371
Loans held for sale securitization	232,384	388,782
Non-recourse debt	3,282,378	3,665,316
Recourse debt	537,098	1,032,733
Shareholders' equity	325,072	452,804
Book value per common share	16.743	27.75

Collateral for Collateralized Bonds

Collateral for collateralized bonds consists primarily of securities backed by adjustable-rate and fixed-rate mortgage loans secured by first liens on single family properties, fixed-rate loans secured by first liens on multifamily and commercial properties, manufactured housing installment loans secured by either a UCC filing or a motor vehicle title and property tax receivables. As of December 31, 1999, Dynex REIT had 27 series of collateralized bonds outstanding. The collateral for collateralized bonds decreased to \$3.7 billion at December 31, 1999 compared to \$4.3 billion at December 31, 1998. This decrease of \$0.6 billion is primarily the result of \$1.1 billion in paydowns on collateral, offset by the net addition of \$0.6 billion of collateral as a result of the issuance of three series of collateralized bonds during 1999.

Securities

Securities consist primarily of fixed-rate "funding notes and securities" secured by automobile installment contracts and adjustable-rate and fixed-rate mortgage-backed securities. Securities also include derivative and residual securities. Derivative securities are classes of collateralized bonds, mortgage pass-through certificates or mortgage certificates that pay to the holder substantially all interest (i.e., an interest-only security), or substantially all principal (i.e., a principal-only security). Residual interests represent the right to receive the excess of (i) the cash flow from the collateral pledged to secure related mortgage-backed securities, together with any reinvestment income thereon, over (ii) the amount required for principal and interest payments on the mortgage-backed securities or repurchase arrangements, together with any related administrative expenses. Securities decreased to \$127.7 million at December 31, 1999 compared to \$244.0 million at December 31, 1998. The decrease was primarily the result of \$79.0 million of paydowns and the sale of \$70.7 million of securities during 1999. These decreases were partially offset by the purchase of \$23.7 million of securities during 1999.

Other Investments

Other investments consist primarily of property tax receivables and a note receivable received in connection with the sale of the Company's single family mortgage operations in May 1996. Other investments increased from \$30.4 million at December 31, 1998 to \$48.9 million at December 31, 1999. This increase of \$18.5 million is primarily the result of the purchase of \$20.5 million of property tax receivables during 1999.

Loans Held for Sale or Securitization

Loans held for sale or securitization decreased from \$388.8 million at December 31, 1998 to \$232.4 million at December 31, 1999. This decrease was primarily due to the securitization of \$605.2 million of loans as collateral for collateralized bonds, the sale of \$62.9 million of loans and the receipt of \$27.7 million of paydowns during 1999. In addition, Dynex REIT

recorded \$31.6 million of writedowns on the commercial loans held for sale and wrote-off \$28.4 million of deferred hedging positions which related to expired commercial loan commitments. These decreases were partially offset by new loan fundings from the Company's production operations totaling \$639.3 million during 1999.

Non-recourse Debt

Collateralized bonds issued by Dynex REIT are recourse only to the assets pledged as collateral, and are otherwise non-recourse to Dynex REIT. Collateralized bonds decreased to \$3.3 billion at December 31, 1999 from \$3.7 billion at December 31, 1998. This decrease was primarily a result of principal paydowns made on all collateralized bonds of \$1.1 billion during 1999. This decrease was partially offset by Dynex REIT adding \$2.1 billion of collateralized bonds during 1999. Of this \$2.1 billion of collateralized bonds, \$1.5 billion related to the collapse and resecuritization of eight series of previously issued collateralized bonds.

Recourse Debt

Recourse debt decreased to \$0.5 billion at December 31, 1999 from \$1.0 billion at December 31, 1998. This decrease was primarily due to the securitization of \$601.8 million of manufactured housing loans as collateral for collateralized bonds during 1999. These loans and securities were previously financed with \$190.7 million of repurchase agreements and \$328.4 million of notes payable. In addition, Dynex REIT paid off \$175.8 million of notes payable primarily as a result of the sale of the Company's model home purchase/leaseback operations during 1999 and sold \$70.7 million of securities which had been financed with \$48.1 million of repurchase agreements during 1999. Also, repurchase agreements decreased \$88.0 million as a result of the re-securitization of the collateral on the previously retained collateralized bonds during 1999. These decreases were partially offset by the addition of \$391.8 million of notes payable as a result of additional loan fundings during 1999.

Shareholders' Equity

Shareholders' equity decreased to \$325.1 million at December 31, 1999 from \$452.8 million at December 31, 1998. This decrease was a combined result of a \$45.4 million increase in the net unrealized loss on investments available for sale from \$3.1 million at December 31, 1998 to \$48.5 million at December 31, 1999 and a net loss after extraordinary item of \$75.1 million during 1999. Dynex REIT also declared dividends of \$6.5 million during 1999, resulting in a decline in shareholder's equity of such amount. In addition, Dynex REIT repurchased 66,100 of its common shares at an aggregate purchase price of \$0.7 million during 1999.

RESULTS OF OPERATIONS

<i>(amounts in thousands except per share information)</i>	For the Year Ended December 31,		
	1999	1998	1997
Net interest margin	\$ 48,015	\$ 66,538	\$ 83,454
Write-downs associated with commercial production operations	(59,962)	-	-
(Loss) gain on sale of investments and trading activities	(12,682)	(2,714)	11,584
Gain on sale of loan production operations	7,676	-	-
Impairment charge and litigation provision - AutoBond	(31,732)	(17,632)	-
Equity in (losses) earnings of DHI	(1,923)	2,456	(1,109)
General and administrative expenses	7,740	8,973	9,531
Net administrative fees and expenses to Dynex Holding, Inc.	16,943	22,379	12,116
Net income (loss) before preferred stock dividends	(75,135)	19,577	73,998
Basic net income (loss) per common share ⁽¹⁾	\$ (7.67)	\$ 0.57	\$ 5.50
Diluted net income (loss) per common share ⁽¹⁾	\$ (7.67)	\$ 0.57	\$ 5.48
Dividends declared per share:			
Common ⁽¹⁾	\$ -	3.40	5.42
Series A and B Preferred	1.17	2.37	2.71
Series C Preferred	1.46	2.92	2.92

(1) Adjusted for both the two-for-one common stock split effective May 5, 1997 and the one-for-four reverse common stock split effective August 2, 1999.

1999 Compared to 1998. The decrease in net income and net income per common share during 1999 as compared to 1998 is primarily the result of (i) a decrease in net interest margin (ii) an increase in the loss on sale of investments and trading

activities and (iii) write-downs associated with the commercial loan production operations. These decreases were partially offset by the reduction in general and administrative expenses and net administrative fees and expenses to Dynex Holding, Inc. and the gain on the sale of the model home purchase/leaseback and the manufactured housing lending operations in 1999.

Net interest margin for the year ended December 31, 1999 decreased to \$48.0 million, or 27.8%, over net interest margin of \$66.5 million for the same period in 1998. This decrease in net interest margin was primarily the result of the decline in average interest-earning assets from \$5.4 billion for the year ended December 31, 1998 to \$4.6 billion for the year ended December 31, 1999. In addition, provision for losses increased to \$16.2 million or 0.35% on an annualized basis of interest-earnings assets during the year ended December 31, 1999, compared to \$6.4 million and 0.12% during the same period in 1998. This increase in provision for losses was a result of increasing the reserve for probable losses on the various loan pools pledged as collateral for collateralized bonds where the Company has retained credit risk.

During 1999, Dynex REIT recorded a loss of \$31.6 million related to the writedown of \$261.9 million of multifamily and commercial loans held for sale at December 31, 1999. In addition, the Company realized losses of \$28.4 million, which were primarily related to the write-off of previously deferred hedging costs on \$255.6 million of multifamily and commercial loan commitments which expired and were not extended by the Company during the fourth quarter of 1999 or the first quarter of 2000. These costs were related to now-closed options and futures positions entered into by the Company in 1998 and 1999.

The net loss on sale of investments and trading activities for the year ended December 31, 1999 increased to \$12.7 million, as compared to \$2.7 million for the same period in 1998. The increase for the year ended December 31, 1999 is primarily the result of a \$9.3 million loss on the sale of \$70.7 million of securities during 1999 and a \$7.4 million loss on the sale of \$58.7 million of commercial loans during 1999. These increases were partially offset by \$4.2 million of realized gains on various derivative trading positions entered into during 1999. The loss on sale of investments and trading activities during 1998 is primarily the results of net losses recognized of \$1.4 million on trading positions entered into during 1998.

During 1999, Dynex REIT recorded an impairment charge of \$4.7 million relating to the funding notes and other AutoBond securities held by the Company at December 31, 1999. In addition, Dynex REIT recorded a charge of \$27.0 million related to the establishment of a reserve for the AutoBond litigation discussed in Item 3. Legal Proceedings. During 1998, Dynex REIT recorded charges to earnings totaling \$17.6 million in regard to AutoBond related assets. This charge included an impairment charge on the funding notes of \$14.0 million and \$3.6 million to other AutoBond related securities.

Net administrative fees and expenses to Dynex Holding, Inc. decreased \$5.5 million, or 24.3%, to \$16.9 million in the year ended December 31, 1999. This decrease is primarily the result of decreased origination volume of the Company's commercial loan production operations and the sale of the Company's model home purchase/leaseback and manufactured housing loan production operations during 1999.

1998 Compared to 1997. The decrease in net income during 1998 as compared to 1997 is primarily the result of (i) a decrease in net interest margin, (ii) a decrease in the gain on sale of investments and trading activities, (iii) an impairment charge on AutoBond related assets, and (iv) an increase in net administrative fees and expenses to Dynex Holding, Inc. The decrease in net income per common share during 1998 as compared to 1997 is the combined result of the decrease in net income and an increase in the average number of common shares outstanding due to the issuance of new common stock and the partial conversion of outstanding preferred stock.

Net interest margin for the year ended December 31, 1998 decreased to \$66.5 million, or 20.3%, over net interest margin of \$83.5 million for the same period in 1997. This decrease in net interest margin was primarily the result of a \$9.1 million increase in premium amortization expense during the year ended December 31, 1998 compared to the year ended December 31, 1997. The increase in premium amortization resulted from a higher rate of prepayments in the investment portfolio during the year ended December 31, 1998 than during the same period in 1997. In addition, the net interest spread on the investment portfolio decreased to 1.20% for the year ended December 31, 1998 from 1.42% for the same period in 1997. The decrease in the net interest spread is also primarily the result of higher premium amortization as a result of the increase in principal prepayments as well as the decrease in spreads between the indices on which the interest-earning assets (primarily six-month LIBOR and the one-year Constant Maturity Treasury) and interest-bearing liabilities (primarily one-month LIBOR) are based.

The (loss) gain on sale of investments and trading activities for 1998 decreased to a \$2.7 million loss, as compared to a \$11.6 million gain for 1997. This decrease is primarily the result of net losses recognized of \$1.4 million on trading positions entered into during the twelve months ended December 31, 1998. The gain on sale of assets during 1997 is primarily the

result of premiums received of \$9.9 million on covered call options and put options written during 1997 and gains generated of \$0.6 million on the sale of certain investments.

The Company recorded charges to earnings totaling \$17.6 million in regard to AutoBond related assets. This charge included an impairment charge on the funding notes of \$14.0 million. It also included a \$0.6 million charge to the Company's investment in AutoBond common and preferred stock to its quoted market value at December 31, 1998. The Company also fully reserved for the \$3.0 million senior convertible note it acquired from AutoBond.

Net administrative fees and expenses to DHI increased \$10.3 million, or 84.7%, to \$22.4 million in 1998. This increase was primarily a result of the continued growth in the Company's production operations, primarily in the manufactured housing and commercial lending business.

The following table summarizes the average balances of interest-earning assets and their average effective yields, along with the average interest-bearing liabilities and the related average effective interest rates, for each of the periods presented.

Average Balances and Effective Interest Rates

<i>(amounts in thousands)</i>	Year ended December 31,					
	1999		1998		1997	
	Average Balance	Effective Rate	Average Balance	Effective Rate	Average Balance	Effective Rate
Interest-earning assets (1):						
Collateral for collateralized bonds (2) (3)	\$ 3,828,007	7.43%	\$ 4,094,030	7.43%	\$2,775,494	7.53%
Securities	226,908	6.27	565,625	7.62	1,110,646	8.36
Other investments	202,111	8.50	196,759	8.17	136,189	8.27
Loans held for sale or securitization	329,507	7.97	546,272	8.14	499,115	7.95
Total interest-earning assets	\$ 4,586,533	7.46%	\$ 5,402,686	7.54%	\$4,521,444	7.80%
Interest-bearing liabilities:						
Non-recourse debt (3)	\$ 3,363,095	6.18%	\$ 3,544,898	6.41%	\$2,226,894	6.67%
Recourse debt – collateralized bonds retained	271,919	5.71	523,208	5.90	419,621	5.82
	3,635,014	6.14	4,068,106	6.34	2,646,515	6.53
Recourse debt secured by investments:						
Securities	143,392	6.51	422,164	5.91	931,334	5.74
Other investments	145,808	6.49	108,361	6.83	24,611	7.05
Loans held for sale or securitization	259,061	5.50	415,778	5.57	354,116	5.83
Recourse debt – unsecured	121,743	8.78	143,378	8.97	87,881	9.23
Total interest-bearing liabilities	\$ 4,305,018	6.21%	\$ 5,157,787	6.34%	\$4,044,457	6.38%
Net interest spread on all investments (3)		1.25%		1.20%		1.42%
Net yield on average interest-earning assets		1.63%		1.49%		2.10%

(1) Average balances exclude adjustments made in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities," to record available for sale securities at fair value.

(2) Average balances exclude funds held by trustees of \$1,844, \$3,189 and \$2,481 for the years ended December 31, 1999, 1998 and 1997, respectively.

(3) Effective rates are calculated excluding non-interest related collateralized bond expenses and provision for credit losses.

1999 compared to 1998. The net interest spread increased to 1.25% for the year ended December 31, 1999 from 1.20% for the same period in 1998. This increase was primarily due to a reduction in premium amortization expense related to collateral for collateralized bonds, which decreased from \$27.5 million for the year ended December 31, 1998 to \$16.3 million for the year ended December 31, 1999. The overall yield on interest-earning assets decreased to 7.46% for the year ended December 31, 1999 from 7.54% for the same period in 1998. The cost of interest-bearing liabilities decreased to 6.21% for the year ended December 31, 1999 from 6.34% for the same period in 1998.

Individually, the net interest spread on collateral for collateralized bonds increased 20 basis points, from 109 basis points from the year ended December 31, 1998 to 129 basis points for the same period in 1999. This increase was primarily due to lower premium amortization caused by decreased prepayments during the year ended December 31, 1999 compared to the same period in 1998. The net interest spread on securities decreased 195 basis points, from 171 basis points for the year ended December 31, 1998 to a negative 24 basis points for the year ended December 31, 1999. This decrease was primarily the result of a 150 basis point increase during 1999 of the interest rate on the notes payable secured by the Funding Notes, from one-month LIBOR plus 150 basis points to one-month LIBOR plus 300 basis points, and the sale of certain higher coupon collateral during the third quarter of 1998. In addition, several of the Company's residual ARM trusts were placed on non-accrual status during the third quarter of 1998. The net interest spread on other investments increased 67 basis points, from 134 basis points for the year ended December 31, 1998 to 201 basis points for the same period in 1999, primarily due to the purchase of higher yielding property tax receivables during 1999. The net interest spread on loans held for sale or securitization decreased 10 basis points, from 257 basis points for the year ended December 31, 1998, to 247 basis points for the same period in 1999. This decrease is primarily attributable to the funding of lower coupon collateral during 1999.

1998 compared to 1997. The net interest spread decreased to 1.20% for the year ended December 31, 1998 from 1.42% for the same period in 1997. This decrease was due to the reduction in interest-earning asset yields from increased premium amortization expense and the addition of lower yielding assets to the investment portfolio. The overall yield on interest-earning assets decreased to 7.54% for year ended December 31, 1998, from 7.80% for the same period in 1997 while the cost of interest-bearing liabilities remained relatively flat for the year ended December 31, 1998 compared to the same period in 1997.

Individually, the net interest spread on collateralized bonds increased 9 basis points, from 100 basis points for the year ended December 31, 1997 to 109 basis points for the same period in 1998. This slight increase was primarily due to the securitization of collateral which has a lower premium as a percentage of principal, during the second quarter of 1998. In addition, one-month LIBOR decreased 27 basis points during the fourth quarter of 1998 which increased the net interest spread on collateralized bonds since the ARM loans underlying the collateralized bonds take on average three to six months to adjust to lower interest rates. The net interest spread on securities decreased 91 basis points, from 262 basis points for the year ended December 31, 1997 to 171 basis points for the year ended December 31, 1998. This decrease was primarily the result of the sale of certain higher coupon collateral during the third quarter of 1998 along with the purchase of lower coupon fixed-rate mortgage securities during the first quarter of 1998. In addition, certain assets were placed on non-accrual status during 1998. The net interest spread on other investments increased 12 basis points, from 122 basis points for the year ended December 31, 1997, to 134 basis points for the year ended December 31, 1998, due primarily to lower borrowing costs associated with the Company's single family model home purchase and leaseback business during 1998. The net interest spread on loans held for securitization increased 45 basis points, from 212 basis points for the year ended December 31, 1997, to 257 basis points for the same period in 1998. This increase is primarily attributable to lower borrowing costs as a result of higher level of compensating cash balances during the year ended December 31, 1998 compared to the same period in 1997. Credits earned from these compensating cash balances are used by the Company to offset interest expense.

The following tables summarize the amount of change in interest income and interest expense due to changes in interest rates versus changes in volume:

	1999 to 1998			1998 to 1997		
	Rate	Volume	Total	Rate	Volume	Total
Collateral for collateralized bonds	\$ 245	\$ (19,769)	\$ (19,524)	\$ (2,895)	\$ 97,943	\$ 95,048
Securities	(6,582)	(22,280)	(28,862)	(7,583)	(42,135)	(49,718)
Other investments	667	444	1,111	(141)	4,949	4,808
Loans held for sale or securitization	(870)	(17,303)	(18,173)	933	3,820	4,753
Total interest income	(6,540)	(58,908)	(65,448)	(9,686)	64,577	54,891
Non-recourse debt	(7,905)	(11,401)	(19,306)	(5,991)	84,638	78,647
Recourse debt - collateralized bonds retained	(939)	(14,386)	(15,325)	342	6,106	6,448
Total collateralized bonds	(8,844)	(25,787)	(34,631)	(5,649)	90,744	85,095
Recourse debt secured by investments:						
Securities	2,322	(18,174)	(15,852)	1,603	(30,484)	(28,881)
Other investments	(391)	2,481	2,090	(55)	5,804	5,749
Loans held for sale or securitization	(281)	(8,739)	(9,020)	(990)	3,514	2,524
Recourse debt - unsecured	(267)	(1,905)	(2,172)	(235)	4,986	4,751
Total interest expense	(7,461)	(52,124)	(59,585)	(5,326)	74,564	69,238
Net margin on portfolio	\$ 921	\$ (6,784)	\$ (5,863)	\$ (4,360)	\$ (9,987)	\$ (14,347)

Note: The change in interest income and interest expense due to changes in both volume and rate, which cannot be segregated, has been allocated proportionately to the change due to volume and the change due to rate. This table excludes net interest income on advances to DHI, other interest expense and provision for credit losses.

Interest Income and Interest-Earning Assets

Approximately \$1.6 billion of the investment portfolio as of December 31, 1999 is comprised of loans or securities that have coupon rates which adjust over time (subject to certain periodic and lifetime limitations) in conjunction with changes in short-term interest rates. Approximately 64% of the ARM loans underlying the ARM securities and collateral for collateralized bonds are indexed to and reset based upon the level of six-month LIBOR; approximately 27% are indexed to and reset based upon the level of the one-year Constant Maturity Treasury (CMT) index. The following table presents a breakdown, by principal balance, of the Company's collateral for collateralized bonds and ARM and fixed mortgage securities by type of underlying loan. This table excludes other derivative and residual securities, other securities, other investments and loans held for securitization.

Investment Portfolio Composition (1)

(\$ in millions)

December 31,	Other Indices			Fixed-Rate Loans	Total
	LIBOR Based ARM Loans	CMT Based ARM Loans	Based ARM Loans		
1998	\$ 1,644.0	\$ 720.4	\$ 195.4	\$ 1,704.0	\$ 4,263.8
1999	1,048.5	430.8	121.1	2,061.5	3,661.9

(1) Includes only the principal amount of collateral for collateralized bonds, ARM securities and fixed securities.

The average asset yield is reduced for the amortization of premiums, net of discounts on the investment portfolio. As indicated in the table below, premiums on the collateral for collateralized bonds, ARM securities and fixed-rate securities at December 31, 1999 were \$38.3 million, or approximately 103% of the aggregate balance of collateral for collateralized bonds, ARM securities and fixed-rate securities. Of this \$38.3 million, \$34.5 million relates to the premium on multifamily and commercial mortgage loans that have prepayment lockouts or yield maintenance for at least seven years. Amortization expense as a percentage of principal paydowns has increased to 1.43% for the year ended December 31, 1999 from 1.24% primarily due to the multifamily and commercial securitization during the fourth quarter of 1998. The amortization expense as a percentage of principal paydowns decreased from 1.85% for the year ended December 31, 1997 to 1.24% for the same period in 1998 as the investment portfolio mix changed to assets funded primarily at par or at a discount during 1998. The principal repayment rate (indicated in the table below as "CPR Annualized Rate") was 20 % for the year ended December 31,

1999. CPR or “constant prepayment rate” is a measure of the annual prepayment rate on a pool of loans. Excluded from this table are loans held for sale or securitization, which are carried at the lower of cost or market as of December 31, 1999.

Premium Basis and Amortization
(\$ in millions)

	Net Premium	Amortization Expense	CPR Annualized Rate	Principal Paydowns	Amortization Expense as a % of Principal Paydowns
1997	\$ 56.9	\$ 18.4	37%	\$ 993.2	1.85%
1998	77.8	27.5	41%	2,215.2	1.24%
1999	38.3	16.3	20%	1,145.8	1.43%

Credit Exposures

The Company securitizes its loan production into collateralized bonds or pass-through securitization structures. With either structure, the Company may use overcollateralization, subordination, third-party guarantees, reserve funds, bond insurance, mortgage pool insurance or any combination of the foregoing as a form of credit enhancement. With all forms of credit enhancement, the Company may retain a limited portion of the direct credit risk after securitization.

The following table summarizes the aggregate principal amount of collateral for collateralized bonds and ARM and fixed-rate mortgage pass-through securities outstanding; the direct credit exposure retained by the Company (represented by the amount of overcollateralization pledged and subordinated securities owned by the Company and rated below BBB by one of the nationally recognized rating agencies), net of the credit reserves maintained by the Company for such exposure; and the actual credit losses incurred for each year. Credit reserves maintained by the Company and included in the table below includes third-party reimbursement guarantees of \$30.3 million. The table excludes any risks related to representations and warranties made on loans funded by the Company and securitized in mortgage pass-through securities generally funded prior to 1995. This table also excludes any credit exposure on loans held for sale or securitization, funding notes and securities, and other investments. The increase in net credit exposure as a percentage of the outstanding loan principal balance from 3.64% at December 31, 1998 to 4.86% at December 31, 1999 is related primarily to the credit exposure retained by the Company on its manufactured housing securitizations issued during 1999.

Credit Reserves and Actual Credit Losses
(\$ in millions)

	Outstanding Loan Principal Balance	Credit Exposure, Net of Credit Reserves	Actual Credit Losses	Credit Exposure, Net of Credit Reserves to Outstanding Loan Balance
1997	\$ 5,153.1	\$ 86.6	\$ 19.8	1.68%
1998	4,389.7	159.7	20.3	3.64%
1999	3,770.3	183.2	19.7	4.86%

The following table summarizes single family mortgage loan, manufactured housing loan and commercial mortgage loan delinquencies as a percentage of the outstanding collateral balance for those securities in which Dynex REIT has retained a portion of the direct credit risk. The delinquencies as a percentage of the outstanding collateral decreased to 1.64% at December 31, 1999 from 2.36% at December 31, 1998. The Company monitors and evaluates its exposure to credit losses and has established reserves based upon anticipated losses, general economic conditions and trends in the investment portfolio. As of December 31, 1999, management believes the level of credit reserves are sufficient to cover any losses which may occur as a result of current delinquencies presented in the table below.

Delinquency Statistics (1)

December 31,	60 to 89 days delinquent	90 days and over delinquent (2)	Total
1997	0.51%	2.82%	3.33%
1998	0.25%	2.11%	2.36%
1999	0.27%	1.37%	1.64%

(1) Excludes funding notes and securities.

(2) Includes foreclosures, repossessions and REO.

The following table summarizes the credit rating for collateral for collateralized bonds, securities and certain other investments held in the investment portfolio, presented on a gross basis (i.e., the collateralized bonds are not netted against the associated pledged collateral). This table excludes \$18.1 million of other derivative and residual securities (as the risk on such securities is primarily prepayment-related, not credit-related), other investments and loans held for sale or securitization. The table also excludes the Funding Notes and Securities, aggregating \$90.7 million, which are not rated. The balance of the investments rated below A are net of credit reserves and discounts. All balances exclude the related mark-to-market adjustment on such assets. At December 31, 1999, securities with a credit rating of AA or better were \$3.2 billion, or 90.4% of the total.

Investments by Credit Rating (1)

(\$ in millions)

December 31,	AAA/AA Carrying Value	A Carrying Value	BBB Carrying Value	Below BBB Carrying Value	AAA/AA Percent of Total	A Percent of Total	BBB Percent of Total	Below BBB Percent of Total
1998	\$ 3,815.6	\$ 206.2	\$ 97.6	\$ 14.4	92.3%	5.0%	2.4%	0.3%
1999	3,154.4	191.4	123.3	19.8	90.4%	5.5%	3.5%	0.6%

(1) Carrying value does not include funding notes and securities, derivative and residual securities, certain other investments which are not debt securities and loans held for securitization. Balances also exclude the mark-to-market adjustment. Carrying value also excludes \$238.3 million of overcollateralization, net of \$55.1 million of reserves.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS No. 133"). FAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variable cash flows of a forecasted transaction, or (c) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security, or a foreign-currency-denominated forecasted transaction. In June 1999, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133" ("FAS No. 137"). FAS No. 137 amends FAS No. 133 to defer its effective date to all fiscal quarters of all fiscal years beginning after June 15, 2000. The Company is in the process of determining the impact of adopting FAS No. 133.

LIQUIDITY AND CAPITAL RESOURCES

The Company finances its operations from a variety of sources. These sources include cash flow generated from the investment portfolio, including net interest income and principal payments and prepayments, common stock offerings through the dividend reinvestment plan, short-term warehouse lines of credit with commercial and investment banks, repurchase agreements and the capital markets via the asset-backed securities market (which provides long-term non-recourse funding of the investment portfolio via the issuance of collateralized bonds). Historically, cash flow generated from the investment portfolio has satisfied its working capital needs, and the Company has had sufficient access to capital to fund its loan production operations, on both a short-term (prior to securitization) and long-term (after securitization) basis. However, market conditions since October 1998 have substantially reduced the Company's access to capital. The Company is currently unable to access additional short-term warehouse lines of credit to replace maturing lines, and is unable to access efficiently the asset-backed securities market to meet its long-term funding needs. Largely as a result of its inability to access additional capital, the Company sold its manufactured housing and model home purchase/leaseback operations in 1999, and ceased issuing new commitments in its commercial lending operations. The Company is attempting to substantially reduce both its short-term debt and capital requirements. The Company's current focus is the repayment of its recourse debt, which includes substantially all of the short-term warehouse lines of credit and repurchase agreements.

A substantial portion of the assets are pledged to secure indebtedness incurred by Dynex REIT. Accordingly, those assets would not be available for distribution to any general creditors or the stockholders of Dynex REIT in the event of the liquidation, except to the extent that the liquidation proceeds of such assets exceeds the amount of the indebtedness they secure.

As more fully described below, the Company was in default of certain covenants in its secured credit facilities and its unsecured senior notes issued in September 1994. As of April 14, 2000, the Company had not secured waivers for all of the defaults; however, none of the respective lenders had accelerated amounts outstanding as of that date as a result of the defaults. See further discussion in Liquidity and Capital Resources and Notes 1 and 7 in the accompanying consolidated financial statements.

Non-recourse Debt

Dynex REIT, through limited-purpose finance subsidiaries, has issued non-recourse debt in the form of collateralized bonds to fund the majority of its investment portfolio. The obligations under the collateralized bonds are payable solely from the collateral for collateralized bonds and are otherwise non-recourse to Dynex REIT. Collateral for collateralized bonds are not subject to margin calls. The maturity of each class of collateralized bonds is directly affected by the rate of principal prepayments on the related collateral. Each series is also subject to redemption according to specific terms of the respective indentures, generally when the remaining balance of the bonds equals 35% or less of the original principal balance of the bonds. At December 31, 1999, Dynex REIT had \$3.3 billion of collateralized bonds outstanding as compared to \$3.7 billion at December 31, 1998.

Recourse Debt

Secured. At December 31, 1999, Dynex REIT had four committed credit facilities aggregating \$699 million, comprised of (i) a \$195 million credit line, expiring on May 29, 2000, from a consortium of commercial banks primarily for the warehousing of multifamily construction and permanent loans (including providing the letters of credit for tax-exempt bonds), (ii) a \$400 million credit line, expiring on April 28, 2000 from an investment bank primarily for the warehousing of permanent loans on multifamily and commercial properties, (iii) a \$100 million credit line, expiring on May 10, 2000 from an investment bank for the warehousing of the funding notes and securities, and (iv) a \$4 million credit line, expiring on December 15, 2000, from a finance company for the warehousing of model homes not included in the sale of the related business. While Dynex REIT has received bids for the sale of a substantial portion of the assets that secure the credit lines expiring on April 28, 2000 and May 29, 2000, it is unlikely that Dynex REIT will be able to payoff such credit lines by the respective maturity dates. Although, the Company will seek extensions to the maturity dates, there can be no assurances that the lenders will agree to such extensions. In the event that the lenders declare an event of default, the underlying credit line agreements provide for the liquidation of the pledged collateral. In such a scenario it is likely that the Company will suffer losses on the sale of the collateral. For the credit line expiring May 10, 2000, Dynex REIT and the lender executed a letter of intent dated April 10, 2000 whereby the collateral currently pledged to the line is instead pledged to a senior/subordinate security structure. Under the terms of the letter, the lender will "purchase" the senior security, the proceeds of which are then used to repay the remaining amount outstanding under the credit line. Dynex REIT will retain the subordinate class. The security will provide for the full amortization of the senior class before any cash flow is paid on the subordinate class. The

above lines of credit include various representations and covenants. Dynex REIT was in violation of certain covenants on the credit lines expiring on April 28, 2000 and May 29, 2000 relating primarily to minimum net worth and minimum senior unsecured ratings requirements, and the receipt of a going concern opinion from its auditors. Dynex REIT has received waivers from the investment bank on the credit line expiring on April 28, 2000 for the minimum senior unsecured ratings and minimum net worth requirements. Dynex REIT has not received a waiver for the uncured covenant violation for the receipt of a going concern opinion. As of April 14, 2000, the investment bank has not notified the Company formally in writing as required by the loan agreement that it has (i) terminated its commitments to lend or (ii) declared all or a portion of the loan due and payable. Dynex REIT has also not received waivers for any uncured covenant violations from the bank consortium on the credit line expiring on May 29, 2000. As of April 14, 2000, the bank syndicate has not formally notified Dynex REIT in writing as required by the loan documentation, that it has (i) terminated its commitment to lend or (ii) declared all or a portion of the loan due and payable. The Company's recourse credit facilities generally contain cross-default provisions whereby a default under any one credit facility is a default on each of the other credit facilities.

The following table summarizes the committed credit facilities at December 31, 1999 expiring in 2000. Dynex REIT had \$246.2 million outstanding under its committed credit facilities at December 31, 1999.

Committed Credit Facilities
At December 31, 1999
(\$ in millions)

Collateral Type	Credit Limit	Current Outstanding Borrowings	Balance of Pledged Collateral	Expiration of Facility
Various (primarily commercial and manufactured housing)	\$ 195.0	\$ 111.6	\$ 135.9	May 29, 2000
Commercial	400.0	83.6	135.4	April 28, 2000
Funding Notes and Securities	100.0	47.8	115.8	May 10, 2000
Model homes	3.7	3.7	4.1	December 15, 2000
	698.7	246.7	391.2	
Less: deferred facility expenses	-	(0.5)	-	
Total	\$ 698.7	\$ 246.2	\$ 391.2	

Dynex REIT also uses repurchase agreements to finance a portion of its investments, which generally have maturities of thirty-days or less. Repurchase agreements allow Dynex REIT to sell investments for cash together with a simultaneous agreement to repurchase the same investments on a specified date for a price which is equal to the original sales price plus an interest component. At December 31, 1999, outstanding obligations under all repurchase agreements totaled \$163.0 million compared to \$529.1 million at December 31, 1998. As of April 14, 2000, Dynex REIT had repurchase agreements outstanding of \$74.7 million, substantially all with one counterparty. Dynex REIT has provided collateral worth an estimated fair market value of \$91.1 million to support the amount of the repurchase agreement outstanding. All repurchase agreements with such counterparty are on an "overnight" or one-day basis. The following table summarizes the outstanding balances of repurchase agreements by credit rating of the related assets pledged as collateral to support such repurchase agreements as of December 31, 1999 and 1998. The table excludes repurchase agreements used to finance loans held for sale or securitization.

Repurchase Agreements by Rating of Investments Financed
(\$ in millions)

December 31,	AAA	AA	A	BBB	Below BBB	Total
1998	\$ 124.5	\$ 109.5	\$ 91.4	\$ 65.6	\$ -	\$ 391.0
1999	77.9	14.9	4.4	65.3	0.5	163.0

Increases in short-term interest rates, long-term interest rates or market risk could negatively impact the valuation of securities and may limit Dynex REIT's borrowing ability or cause various lenders to initiate margin calls for securities financed using repurchase agreements. Additionally, certain investments are classes of securities rated AA, A or BBB that are subordinated to other classes from the same series of securities. Such subordinated classes may have less liquidity than securities that are not subordinated and the value of such classes is more dependent on the credit rating of the related insurer or the credit performance of the underlying loans or receivables. In instances of a downgrade of an insurer or the

deterioration of the credit quality of the underlying collateral, Dynex REIT may be required to sell certain investments in order to maintain liquidity. If required, these sales could be made at prices lower than the carrying value of the assets, which could result in losses.

Unsecured. Since 1994, Dynex REIT has issued three series of unsecured notes payable totaling \$150 million. These notes payable had an outstanding balance at December 31, 1999 of \$110.8 million. The Company has \$97.3 million outstanding of its July 2002 senior notes (the "2002 Notes") and \$13.5 million outstanding on notes issued in September 1994 (the "1994 Notes"). During the year ended December 31, 1999, Dynex REIT extinguished \$2.75 million of the 2002 Notes resulting in a \$0.6 million extraordinary gain. Effective May 15, 1999, the Company amended the 1994 Notes. In return for certain covenant relief related to the fixed-charge coverage requirements of the 1994 Notes, the Company agreed to (i) convert the principal amortization of the 1994 Notes from annual to monthly and (ii) shorten the remaining principal amortization period from 30 months to 16 months. Monthly amortization for the 1994 Notes through August 2000 approximates \$1.7 million per month. As of December 31, 1999, the Company was in violation of certain covenants in the 1994 Notes including the minimum net worth requirement and the covenant requiring an unqualified audit opinion. These violations resulted in an immediate event of default; however, the holders of the 1994 Notes have not accelerated the remaining amounts due.

The 2002 Notes also contain covenants which provide for the acceleration of amounts outstanding under the 2002 Notes should Dynex REIT default under other credit agreements in excess of \$10 million, and such amounts outstanding under the other credit agreements are accelerated by the respective lender.

Total recourse debt decreased from \$1.0 billion for December 31, 1998 to \$0.5 billion for December 31, 1999. This decrease was primarily due to the securitization of \$601.8 million of manufactured housing loans as collateral for collateralized bonds during 1999. These loans and securities were previously financed with \$190.7 million of repurchase agreements and \$328.4 million of notes payable. In addition, Dynex REIT paid off \$175.8 million of notes payable as a result of the sale of the Company's model home and manufactured housing operation during 1999 and sold \$70.7 million of securities which had been financed with \$48.1 million of repurchased agreements during 1999. Also, repurchase agreements decreased \$88.0 million as a result of the re-securitization of the collateral on the previously retained collateralized bonds during 1999. These decreases were partially offset by the addition of \$391.8 million of notes payable as a result of additional loan fundings during 1999. Total recourse debt should continue to decline during 2000 as Dynex REIT continues to sell loans held for sale and receives payments on the funding notes.

Total Recourse Debt
(\$ in millions)

December 31,	Total Recourse Debt	Total Recourse Debt to Equity	Recourse Interest Coverage Ratio
1997	\$ 1,133.5	212%	1.82%
1998	1,032.7	194%	1.20%
1999	537.1	151%	0.26%

In connection with the AutoBond litigation as discussed in Item 3 Legal Proceedings, in order to appeal the approximately \$27 million proposed judgment, Dynex REIT is generally required to post an appeal bond in an amount equal to the judgment. Dynex REIT's ability to secure an appeal bond is dependent on the amount of the collateral required by the surety bond provider. Generally, appeal bonds are substantially secured by letters of credit or cash. Dynex REIT does not have sufficient cash reserves to fully collateralize an appeal bond or to post a letter of credit. Should Dynex REIT not be able to secure an appeal bond for the full amount of the judgment, Texas State law would allow for Dynex REIT to present evidence to reduce the required amount of the appeal bond or to provide other collateral for the appeal. There can be no assurance that Dynex REIT will be allowed to post a reduced bond.

FOURTH QUARTER REVIEW

The Company reported a net loss of \$72.3 million for the fourth quarter of 1999 and a net loss per common share of \$6.60. These results were an increase from the fourth quarter of 1998 net loss of \$16.9 million and a net loss per common share of \$1.75. The increase in the fourth quarter of 1999 compared to the same period in 1998 is primarily due to a decrease in net interest margin, write-downs associated with the commercial loan operations and the litigation provision.

Net interest margin for the fourth quarter of 1999 totaled \$9.9 million compared with \$17.6 million for the fourth quarter of 1998. The decrease in the net interest margin for the fourth quarter of 1999 was primarily due to an increase in provision for losses and a \$0.8 billion decrease in the average interest-earnings assets for the fourth quarter of 1999 compared to the same period in 1998.

The average interest-earning assets were \$4.3 billion for the fourth quarter of 1999 and \$5.1 billion for same period in 1998. However, the average asset yield for the quarter ended December 31, 1999 increased to 7.80% compared to 7.46% for the fourth quarter of 1998. The increase in the yield during the fourth quarter of 1999 was primarily due to lower premium amortization caused by decreased prepayments during the fourth quarter of 1999. Additionally, the average interest-bearing liabilities decreased \$0.9 billion to \$4.0 billion for the fourth quarter of 1999 compared to \$4.9 billion for the fourth quarter of 1998. The average cost of funds increased from 6.13% for the fourth quarter of 1998 to 6.59% for the fourth quarter of 1999. The increase in the average cost of funds was due primarily to an increase in the average one-month LIBOR for the fourth quarter of 1999 compared to the fourth quarter of 1998.

For the fourth quarter of 1999, the Company recognized a \$4.2 million net loss on the sale of investments and trading activities compared to a loss of \$9.0 million in the fourth quarter of 1998. The loss in the fourth quarter of 1999 was primarily due to \$4.5 million of net losses on \$21.9 million of commercial loans sold during the fourth quarter of 1999, while the loss of \$9.0 million in the fourth quarter of 1998 was primarily a result of \$8.6 million of net losses on \$113.9 million of securities sold during the fourth quarter of 1998.

On March 9, 2000, the jury in the AutoBond related litigation returned a verdict in favor of AutoBond, and awarded AutoBond \$69 million in damages. On April 17, 2000, based on motions filed by the Company, the judge presiding over the matter in Travis County, Texas proposed a judgment of approximately \$27 million (which includes estimated prejudgment interest) in lieu of the approximate \$69 million verdict. *See Item 3. Legal Proceedings.* As a result, the Company recorded a litigation provision of \$27.0 million. The charge was reflected in impairment charges and litigation provision in the accompanying financial statements.

Summary of Selected Quarterly Results (unaudited)
(amounts in thousands except share data)

Year ended December 31, 1999	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating results:				
Total revenues	\$ 88,477	\$ 84,925	\$ 86,308	\$ 91,088
Net interest margin	11,213	14,594	12,274	9,934
Net income (loss)	2,259	3,574	320	(81,288)
Basic net income per common share	(0.08)	0.03	(0.25)	(7.39)
Diluted net income per common share	(0.08)	0.03	(0.25)	(7.39)
Cash dividends declared per common share	-	-	-	-
Annualized return on common shareholders' equity	(1.18%)	0.53%	(3.52%)	(111.43%)
Average interest-earning assets	4,817,483	4,639,592	4,563,995	4,325,061
Average borrowed funds	4,576,714	4,379,658	4,253,524	4,010,174
Net interest spread on interest-earning assets	1.07%	1.39%	1.32%	1.21%
Average asset yield	7.24%	7.24%	7.60%	7.80%
Net yield on average interest-earning assets (1)	1.38%	1.72%	1.74%	1.69%
Cost of funds	6.17%	5.85%	6.28%	6.59%
Loans funded	219,647	294,624	236,384	122,331
Year ended December 31, 1998	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating results:				
Total revenues	\$ 97,842	\$ 111,813	\$ 104,434	\$ 96,732
Net interest margin	17,146	17,187	14,639	17,566
Net income (loss)	14,432	15,599	6,485	(16,939)
Basic net income per common share	0.98	1.08	0.28	(1.75)
Diluted net income per common share	0.98	1.08	0.28	(1.75)
Cash dividends declared per common share	1.20	1.20	1.00	-
Annualized return on common shareholders' equity	12.50%	13.77%	3.68%	(23.79%)
Average interest-earning assets	5,120,191	5,780,504	5,571,742	5,138,306
Average borrowed funds	4,791,147	5,520,722	5,377,659	4,941,623
Net interest spread on interest-earning assets	1.19%	1.17%	1.11%	1.33%
Average asset yield	7.59%	7.61%	7.50%	7.46%
Net yield on average interest-earning assets (1)	1.60%	1.47%	1.33%	1.57%
Cost of funds	6.40%	6.44%	6.39%	6.13%
Loans funded	1,171,665	542,176	435,270	371,126

(1) Computed as net interest margin excluding non-interest collateralized bond expenses.

FORWARD-LOOKING STATEMENTS

Certain written statements in this Form 10-K made by the Company, that are not historical fact constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements may involve factors that could cause the actual results of the Company to differ materially from historical results or from any results expressed or implied by such forward-looking statements. The Company cautions the public not to place undue reliance on forward-looking statements, which may be based on assumptions and anticipated events that do not materialize. The Company does not undertake, and the Securities Litigation Reform Act specifically relieves the Company from, any obligation to update any forward-looking statements.

Factors that may cause actual results to differ from historical results or from any results expressed or implied by forward-looking statements include the following:

Economic Conditions. The Company is affected by general economic conditions. The risk of defaults and credit losses could increase during an economic slowdown or recession. This could have an adverse effect on the Company’s financial performance and the performance on the Company’s securitized loan pools.

Capital Resources. The Company relies on various credit facilities and repurchase agreements with certain commercial and investment banking firms to help meet the Company’s short-term funding needs. The Company is in violation of numerous covenants under its existing credit facilities. The Company’s access to alternative or additional sources of financing has been significantly reduced.

Capital Markets. The Company relies on the capital markets for the sale upon securitization of its collateralized bonds or other types of securities. While the Company has historically been able to sell such collateralized bonds and securities into the capital markets, the Company’s access to capital markets in the future has been substantially reduced.

Interest Rate Fluctuations. The Company’s income depends on its ability to earn greater interest on its investments than the interest cost to finance these investments. Interest rates in the markets served by the Company generally rise or fall with interest rates as a whole. A majority of the loans currently originated by the Company are fixed-rate. The profitability of a particular securitization may be reduced if interest rates increase substantially before these loans are securitized. In addition, the majority of the investments held by the Company are variable rate collateral for collateralized bonds and adjustable-rate investments. These investments are financed through non-recourse long-term collateralized bonds and recourse short-term repurchase agreements. The net interest spread for these investments could decrease during a period of rapidly rising short-term interest rates, since the investments generally have periodic interest rate caps and the related borrowing have no such interest rate caps.

Defaults. Defaults by borrowers on loans retained by the Company may have an adverse impact on the Company’s financial performance, if actual credit losses differ materially from estimates made by the Company at the time of securitization. The allowance for losses is calculated on the basis of historical experience and management’s best estimates. Actual defaults may differ from the Company’s estimate as a result of economic conditions. Actual defaults on ARM loans may increase during a rising interest rate environment. The Company believes that its reserves are adequate for such risks.

Prepayments. Prepayments by borrowers on loans securitized by the Company may have an adverse impact on the Company’s financial performance. Prepayments are expected to increase during a declining interest rate or flat yield curve environment. The Company’s exposure to rapid prepayments is primarily (i) the faster amortization of premium on the investments and, to the extent applicable, amortization of bond discount, and (ii) the replacement of investments in its portfolio with lower yield securities.

Competition. The financial services industry is a highly competitive market. Increased competition in the market could adversely affect the Company.

Regulatory Changes. The Company’s business is subject to federal and state regulation which, among other things require the Company to maintain various licenses and qualifications and require specific disclosures to borrowers. Changes in existing laws and regulations or in the interpretation thereof, or the introduction of new laws and regulations, could adversely affect the performance of the Company’s securitized loan pools.

Significant Uncertainties and Risks. See Note 1 to the Company’s financial statements.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk generally represents the risk of loss that may result from the potential change in the value of a financial instrument due to fluctuations in interest and foreign exchange rates and in equity and commodity prices. Market risk is inherent to both derivative and non-derivative financial instruments, and accordingly, the scope of the Company's market risk management extends beyond derivatives to include all market risk sensitive financial instruments. As a financial services company, net interest income comprises the primary component of the Company's earnings. As a result, the Company is subject to risk resulting from interest rate fluctuations to the extent that there is a gap between the amount of the Company's interest-earning assets and the amount of interest-bearing liabilities that are prepaid, mature or reprice within specified periods. The Company's strategy is to mitigate interest rate risk through the creation of a diversified investment portfolio of high quality assets that, in the aggregate, preserves the Company's capital base while generating stable income in a variety of interest rate and prepayment environments. In many instances, the investment strategy involves not only the creation of the asset, but also structuring the related securitization or borrowing to create a stable yield profile and reduce interest rate risk.

The Company continuously monitors the aggregate cash flow, projected net yield and market value of its investment portfolio under various interest rate and prepayment assumptions. While certain investments may perform poorly in an increasing or decreasing interest rate environment, other investments may perform well, and others may not be impacted at all. Generally, the Company adds investments to its portfolio that are designed to increase the diversification and reduce the variability of the yield produced by the portfolio in different interest rate environments.

The Company's Portfolio Executive Committee ("PEC"), which includes executive management representatives, monitors and manages the interest rate sensitivity and repricing characteristics of the balance sheet components consistent with maintaining acceptable levels of change in both the net portfolio value and net interest income. The Company's exposure to interest rate risk is reviewed on a monthly basis by the PEC and quarterly by the Board of Directors.

The Company utilizes several tools and risk management strategies to monitor and address interest rate risk, including (i) a quarterly sensitivity analysis using option-adjusted spread ("OAS") methodology to calculate the expected change in net interest margin as well as the change in the market value of various assets within the portfolio under various extreme scenarios; and (ii) a monthly static cash flow and yield projection under 49 different scenarios. Such tools allow the Company to continually monitor and evaluate its exposure to these risks and to manage the risk profile of the investment portfolio in response to changes in the market risk. While the Company may use such tools, there can be no assurance the Company will accomplish the goal of adequately managing the risk profile of the investment portfolio.

The Company measures the sensitivity of its net interest income to changes in interest rates. Changes in interest rates are defined as instantaneous, parallel, and sustained interest rate movements in 100 basis point increments. The Company estimates its interest income for the next twelve months assuming no changes in interest rates from those at period end. Once the base case has been estimated, cash flows are projected for each of the defined interest rate scenarios. Those scenario results are then compared against the base case to determine the estimated change to net interest income.

The following table summarizes the Company's net interest margin sensitivity analysis as of December 31, 1999. This analysis represents management's estimate of the percentage change in net interest margin given a parallel shift in interest rates. The "Base" case represents the interest rate environment as it existed as of December 31, 1999. The analysis is heavily dependent upon the assumptions used in the model. The effect of changes in future interest rates, the shape of the yield curve or the mix of assets and liabilities may cause actual results to differ from the modeled results. In addition, certain financial instruments provide a degree of "optionality." The model considers the effects of these embedded options when projecting cash flows and earnings. The most significant option affecting the Company's portfolio is the borrowers' option to prepay the loans. The model uses a dynamic prepayment model that applies a Constant Prepayment Rate ranging from 5.5% to 70.1% based on the projected incentive to refinance for each loan type in any given period. While the Company's model considers these factors, the extent to which borrowers utilize the ability to exercise their option may cause actual results to significantly differ from the analysis. Furthermore, its projected results assume no additions or subtractions to the Company's portfolio, and no change to the Company's liability structure. Historically, the Company has made significant changes to its assets and liabilities, and is likely to do so in the future.

Basis Point Increase (Decrease) in Interest Rates	% Change in Net Interest Margin from Base Case
+200	(33.56)%
+100	(17.12)%
Base	-
-100	13.50%
-200	15.53%

The Company's investment policy sets forth guidelines for assuming interest rate risk. The investment policy stipulates that given a 200 basis point increase or decrease in interest rates over a twelve month period, the estimated net interest margin may not change by more than 25% of current net interest margin during the subsequent one year period. Based on the projections above, the Company is not in compliance with its stated policy regarding the interest rate sensitivity of net interest margin if interest rates increase 200 basis points over a twelve month period.

Approximately \$1.6 billion of the Company's investment portfolio as of December 31, 1999 is comprised of loans or securities that have coupon rates which adjust over time (subject to certain periodic and lifetime limitations) in conjunction with changes in short-term interest rates. Approximately 64% and 27% of the ARM loans underlying the Company's ARM securities and collateral for collateralized bonds are indexed to and reset based upon the level of six-month LIBOR and one-year CMT, respectively.

Generally, during a period of rising short-term interest rates, the Company's net interest spread earned on its investment portfolio will decrease. The decrease of the net interest spread results from (i) the lag in resets of the ARM loans underlying the ARM securities and collateral for collateralized bonds relative to the rate resets on the associated borrowings and (ii) rate resets on the ARM loans which are generally limited to 1% every six months or 2% every twelve months and subject to lifetime caps, while the associated borrowings have no such limitation. As short-term interest rates stabilize and the ARM loans reset, the net interest margin may be restored to its former level as the yields on the ARM loans adjust to market conditions. Conversely, net interest margin may increase following a fall in short-term interest rates. This increase may be temporary as the yields on the ARM loans adjust to the new market conditions after a lag period. In each case, however, the Company expects that the increase or decrease in the net interest spread due to changes in the short-term interest rates to be temporary. The net interest spread may also be increased or decreased by the proceeds or costs of interest rate swap, cap or floor agreements.

Because of the 1% or 2% periodic cap nature of the ARM loans underlying the ARM securities, these securities may decline in market value in a rising interest rate environment. In a rapidly increasing rate environment, as was experienced in 1994, a decline in value may be significant enough to impact the amount of funds available under repurchase agreements to borrow against these securities. In order to maintain liquidity, the Company may be required to sell certain securities. Liquidity risk also exists with all other investments pledged as collateral for repurchase agreements, but to a lesser extent.

As part of its asset/liability management process, the Company enters into interest rate agreements such as interest rate caps and swaps and financial futures contracts ("hedges"). These interest rate agreements are used by the Company to help mitigate the risk to the investment portfolio of fluctuations in interest rates that would ultimately impact net interest income. To help protect the Company's net interest income in a rising interest rate environment, the Company has purchased interest rate caps with a notional amount of \$1.4 billion, which help reduce the Company's exposure to interest rate risk rising above the lifetime interest rate caps on ARM securities and loans. These interest rate caps provide the Company with additional cash flow should the related index increase above the contracted rates. The contracted rates on these interest rate caps are based on one-month LIBOR, six-month LIBOR or one-year CMT. These interest rate cap agreements expire 2001 to 2004. The Company will also utilize interest rate swaps to manage its exposure to changes in financing rates of assets and to convert floating rate borrowings to fixed rate where the associated asset financed is fixed rate. These interest rate swap agreements expire in 2001. Interest rate caps and interest rate swaps that the Company uses to manage certain interest rate risks represent protection for the earnings and cash flow of the investment portfolio in adverse markets. To date, short term interest rates have not risen at the speed or to the extent such that the protective cashflows provided by the caps and swaps have been realized.

The Company may also utilize futures and options on futures to moderate the risks inherent in the financing of a portion of its investment portfolio with floating-rate repurchase agreements. The Company uses these instruments to synthetically

lengthen the terms of repurchase agreement financing, generally from one to three or six months. Interest rate futures and option agreements have historically provided the Company a means of essentially locking-in borrowing costs at specified rates for a specified period of time. Under these contracts, the Company will receive additional cash flow if the underlying index increases above contracted rates, mitigating the net interest income loss that results from the higher repurchase agreement rates. The Company will pay additional cash flow if the underlying index decreases below contracted rates. The Company has not utilized futures or options on futures since 1997, as they primarily benefit the Company when expected rates as measured by the forward yield-curve are less than current cash market rates.

Interest rate caps and interest rate swaps that the Company utilizes to manage certain interest rate risks represent protection for the earnings and cashflow of the investment portfolio in adverse markets. To date, market conditions have not been adverse such that the caps and swaps have been utilized.

The remaining portion of the Company's investments portfolio as of December 31, 1999, approximately \$2.5 billion, is comprised of loans or securities that have coupon rates that are either fixed or do not reset within the next 15 months. The Company has limited its interest rate risk on such investments through (i) the issuance of fixed-rate collateralized bonds and notes payable, and (ii) equity, which in the aggregate totals approximately \$1.8 billion as of the same date. Overall, the Company's interest rate risk is related both to the rate of change in short term interest rates, and to the level of short term interest rates.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements of the Company and the related notes, together with the Independent Auditors' Reports thereon are set forth on pages F-1 through F-28 of this Form 10-K.

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

On July 21, 1998, the Audit Committee of Dynex Capital, Inc. approved the appointment of the accounting firm of Deloitte & Touche LLP ("D&T") as the independent accountants for the year ending December 31, 1998 to replace KPMG Peat Marwick LLP ("KPMG"), who were dismissed as the independent accountants effective with such appointment.

The reports of KPMG on the Company's consolidated financial statements for the year ended December 31, 1997 did not contain an adverse opinion or a disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principles.

In connection with the audits of the Company's consolidated financial statements for the year ended December 31, 1997, and through July 21, 1998, there have been no disagreements between the Company and KPMG on any matter of accounting principles or practices, financial statement disclosure, or auditing scope and procedures which, if not resolved to the satisfaction of KPMG, would have caused them to make reference thereto in their report on the financial statements for such years.

During the year ended December 31, 1997, and through July 21, 1998, the Company had not consulted with D&T regarding either (i) the application of accounting principles to a specified transaction, either completed or proposed; or (ii) any matter that was either the subject of a disagreement, as that term is defined in Item 304 (a) (1) (iv) of Regulation S-K and the related instructions to Item 304 of Regulation S-K, or a reportable event, as that term is defined in Item 304 (a) (1) (v) of Regulation S-K.

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by Item 10 as to directors and executive officers of the Company is included in the Company's proxy statement for its 2000 Annual Meeting of Stockholders (the 2000 Proxy Statement) in the Election of Directors and Management of the Company sections and is incorporated herein by reference.

Item 11. EXECUTIVE COMPENSATION

The information required by Item 11 is included in the 2000 Proxy Statement in the Management of the Company section and is incorporated herein by reference.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by Item 12 is included in the 2000 Proxy Statement in the Ownership of Common Stock section and is incorporated herein by reference.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by Item 13 is included in the 2000 Proxy Statement in the Compensation Committee Interlocks and Insider Participation section and is incorporated herein by reference.

Part IV

Item 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Documents filed as part of this report:

1. and 2. Financial Statements and Financial Statement Schedule

The information required by this section of Item 14 is set forth in the Consolidated Financial Statements and Independent Auditors' Report beginning at page F-1 of this Form 10-K. The index to the Financial Statements and Schedule is set forth at page F-2 of this Form 10-K.

3. Exhibits

Exhibit

Number Exhibit

- 3.1 Articles of Incorporation of the Registrant, as amended, effective as of February 4, 1988. (Incorporated herein by reference to the Company's Amendment No. 1 to the Registration Statement on Form S-3 (No. 333-10783) filed March 21, 1997.)
- 3.2 Amended Bylaws of the Registrant (Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1992, as amended.)
- 3.3 Amendment to the Articles of Incorporation, effective December 29, 1989 (Incorporated herein by reference to the Company's Amendment No. 1 to the Registration Statement on Form S-3 (No. 333-10783) filed March 21, 1997.)
- 3.4 Amendment to Articles of Incorporation, effective June 27, 1995 (Incorporated herein by reference to the Company's Current Report on Form 8-K (File No. 1-9819), dated June 26, 1995.)
- 3.5 Amendment to Articles of Incorporation, effective October 23, 1995 (Incorporated herein by reference to the Company's Current Report on Form 8-K (File No. 1-9819), dated October 19, 1995.)

- 3.6 Amendment to the Articles of Incorporation, effective October 9, 1996 (Incorporated herein by reference to the Registrant's Current Report on Form 8-K, filed October 15, 1996.)
- 3.7 Amendment to the Articles of Incorporation, effective October 10, 1996 (Incorporated herein by reference to the Registrant's Current Report on Form 8-K, filed October 15, 1996.)
- 3.8 Amendment to the Articles of Incorporation, effective October 19, 1992. (Incorporated herein by reference to the Company's Amendment No. 1 to the Registration Statement on Form S-3 (No. 333-10783) filed March 21, 1997.)
- 3.9 Amendment to the Articles of Incorporation, effective August 17, 1992. (Incorporated herein by reference to the Company's Amendment No. 1 to the Registration Statement on Form S-3 (No. 333-10783) filed March 21, 1997.)
- 3.10 Amendment to Articles of Incorporation, effective April 25, 1997. (Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997.)
- 3.11 Amendment to Articles of Incorporation, effective May 5, 1997. (Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997.)
- 10.1 Dividend Reinvestment and Stock Purchase Plan (Incorporated herein by reference to the Company's Registration Statement on Form S-3 (No. 333-35769).)
- 10.2 Executive Deferred Compensation Plan (Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1993 (File No. 1-9819) dated March 21, 1994.)
- 10.3 Employment Agreement: Thomas H. Potts (Incorporated by reference to Exhibits to the Company's Annual Report filed on Form 10-K for the year ended December 31, 1994 (File No. 1-9819) dated March 31, 1995.)
- 10.4 Promissory Note, dated as of May 13, 1996, between the Registrant (as Lender) and Dominion Mortgage Services, Inc. (as Borrower) (Incorporated herein by reference to Exhibits to the Company's Form 10-Q for the quarter ended June 30, 1996 (File No. 1-9819) dated August 14, 1996.)
- 10.5 The Registrant's Bonus Plan (Incorporated by reference to Exhibits to the Company's Annual Report filed on Form 10-K for the year ended December 31, 1996 (File No. 1-9819) dated March 31, 1997.)
- 10.6 The Directors Stock Appreciation Rights Plan (Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997.)
- 10.7 1992 Stock Incentive Plan as amended (Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997.)
- 21.1 List of consolidated entities of the Company (filed herewith)
- 23.1 Consent of Deloitte & Touche LLP (filed herewith)
- 23.2 Consent of KPMG LLP (filed herewith)

(b) Reports on Form 8-K

SIGNATURES

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

DYNEX CAPITAL, INC.
(Registrant)

April 18, 2000

/s/ Thomas H. Potts
Thomas H. Potts
President
(Principal Executive Officer)

April 18, 2000

/s/ Lynn K. Geurin
Lynn K. Geurin
Executive Vice President and Chief Financial Officer
(Principal Accounting and Financial Officer)

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Capacity</u>	<u>Date</u>
<u>/s/ Thomas H. Potts</u> Thomas H. Potts	Director	April 18, 2000
<u>/s/ J. Sidney Davenport, IV</u> J. Sidney Davenport, IV	Director	April 18, 2000
<u>/s/ Barry S. Shein</u> Barry S. Shein	Director	April 18, 2000
<u>/s/ Donald B. Vaden</u> Donald B. Vaden	Director	April 18, 2000

DYNEX CAPITAL, INC.
CONSOLIDATED FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT
For Inclusion in Form 10-K
Annual Report Filed with
Securities and Exchange Commission
December 31, 1999

DYNEX CAPITAL, INC.
INDEX TO FINANCIAL STATEMENTS AND SCHEDULE

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Dynex Capital, Inc.

We have audited the accompanying consolidated balance sheets of Dynex Capital, Inc. and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of operations, shareholder's equity, and cash flows for the years then ended. In connection with our audits of these consolidated financial statements, we also have audited the financial statement schedule. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the companies as of December 31, 1999 and 1998, and the results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole presents fairly, in all material respects, the information set forth therein.

The accompanying consolidated financial statements for the year ended December 31, 1999 have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, litigation, the difficulty the Company is experiencing in accessing new funding sources and the default of certain debt covenants which permit the lenders to accelerate the maturity of the debt raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

DELOITTE & TOUCHE LLP

Richmond, Virginia
April 17, 2000

Independent Auditors' Report

The Board of Directors
Dynex Capital, Inc.:

We have audited the accompanying consolidated statements of operations, shareholders' equity and cash flows of Dynex Capital, Inc. and subsidiaries for the year ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of Dynex Capital, Inc. and subsidiaries for the year ended December 31, 1997, in conformity with generally accepted accounting principles.

KPMG LLP

Richmond, Virginia
February 4, 1998, except as to the 1997
information contained in note 17
which is as of April 14, 1999

CONSOLIDATED BALANCE SHEETS
DYNEX CAPITAL, INC.

December 31, 1999 and 1998

(amounts in thousands except share data)

	1999	1998
ASSETS		
Investments:		
Collateral for collateralized bonds	\$ 3,700,714	\$ 4,293,528
Securities	127,711	243,984
Other investments	48,927	30,371
Loans held for sale or securitization	232,384	388,782
	<u>4,109,736</u>	<u>4,956,665</u>
Investments in and advances to Dynex Holding, Inc.	4,814	169,384
Cash, substantially restricted	48,601	30,103
Accrued interest receivable	2,208	4,162
Other assets	25,537	18,534
	<u>\$ 4,190,896</u>	<u>\$ 5,178,848</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Non-recourse debt	\$ 3,282,378	\$ 3,665,316
Recourse debt:		
Secured by collateralized bonds retained	144,746	298,695
Secured by investments	282,479	588,735
Unsecured	109,873	145,303
	<u>3,819,476</u>	<u>4,698,049</u>
Accrued interest payable	6,303	8,403
Accrued expenses and other liabilities	40,045	16,364
Dividends payable	-	3,228
	<u>3,865,824</u>	<u>4,726,044</u>
Commitments and contingencies – Notes 1, 13 and 14		
SHAREHOLDERS' EQUITY		
Preferred stock, par value \$.01 per share, 50,000,000 shares authorized:		
9.75% Cumulative Convertible Series A, 1,309,061 issued and outstanding	29,900	29,900
9.55% Cumulative Convertible Series B, 1,912,434 issued and outstanding	44,767	44,767
9.73% Cumulative Convertible Series C, 1,840,000 issued and outstanding	52,740	52,740
Common stock, par value \$.01 per share, 100,000,000 shares authorized, 11,444,099 and 46,027,426 issued and outstanding, respectively	114	460
Additional paid-in capital	351,995	352,382
Accumulated other comprehensive loss	(48,507)	(3,097)
Accumulated deficit	(105,937)	(24,348)
	<u>325,072</u>	<u>452,804</u>
	<u>\$ 4,190,896</u>	<u>\$ 5,178,848</u>

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS
DYNEX CAPITAL, INC.

Years ended December 31, 1999, 1998 and 1997
(amounts in thousands except share data)

	1999	1998	1997
Interest income:			
Collateral for collateralized bonds	\$ 284,470	\$ 303,994	\$ 208,946
Securities	14,228	41,991	79,714
Other investments	4,388	4,099	4,909
Loans held for sale or securitization	26,276	44,450	34,099
Net advances to Dynex Holding, Inc.	12,087	10,979	5,891
	<u>341,449</u>	<u>405,513</u>	<u>333,559</u>
Interest and related expense:			
Non-recourse debt	210,794	231,242	152,678
Recourse debt	59,906	99,119	90,777
Other	6,580	2,193	1,717
	<u>277,280</u>	<u>332,554</u>	<u>245,172</u>
Net interest margin before provision for losses	64,169	72,959	88,387
Provision for losses	(16,154)	(6,421)	(4,933)
Net interest margin	<u>48,015</u>	<u>66,538</u>	<u>83,454</u>
Write-downs associated with commercial production operations	(59,962)	-	-
(Loss) gain on sale of investments and trading activities	(12,682)	(2,714)	11,584
Gain on sale of loan production operations	7,676	-	-
Impairment charge and litigation provision - AutoBond	(31,732)	(17,632)	-
Equity in net (loss) earnings of Dynex Holding, Inc.	(1,923)	2,456	(1,109)
Other income	1,673	2,852	1,716
	<u>(48,935)</u>	<u>51,500</u>	<u>95,645</u>
General and administrative expenses	(7,740)	(8,973)	(9,531)
Net administrative fees and expenses to Dynex Holding, Inc.	(16,943)	(22,379)	(12,116)
(Loss) income before extraordinary item	<u>(73,618)</u>	<u>20,148</u>	<u>73,998</u>
Extraordinary item - loss on extinguishment of debt	(1,517)	(571)	-
Net (loss) income	<u>(75,135)</u>	<u>19,577</u>	<u>73,998</u>
Dividends on preferred stock	(12,910)	(13,019)	(14,820)
Net (loss) income available to common shareholders	<u>\$ (88,045)</u>	<u>\$ 6,558</u>	<u>\$ 59,178</u>
Net (loss) income per common share before extraordinary item:			
Basic	<u>\$ (7.53)</u>	<u>\$ 0.62</u>	<u>\$ 5.50</u>
Diluted	<u>\$ (7.53)</u>	<u>\$ 0.62</u>	<u>\$ 5.48</u>
Net (loss) income per common share after extraordinary item:			
Basic	<u>\$ (7.67)</u>	<u>\$ 0.57</u>	<u>\$ 5.50</u>
Diluted	<u>\$ (7.67)</u>	<u>\$ 0.57</u>	<u>\$ 5.48</u>

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
DYNEX CAPITAL, INC.

Years ended December 31, 1999, 1998 and 1997
(amounts in thousands except share data)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive (Loss) Income	Retained Earnings (Accumulated Deficit)	Total
Balance at January 1, 1997	\$ 139,625	\$ 207	\$ 291,637	\$ 64,402	\$ 7,746	\$ 503,617
Comprehensive income:						
Net income – 1997	-	-	-	-	73,998	73,998
Change in net unrealized gain on investments classified as available for sale during the period	-	-	-	15,039	-	15,039
Total comprehensive income	-	-	-	15,039	73,998	89,037
Issuance of common stock	-	25	42,009	-	-	42,034
Conversion of preferred stock	(9,143)	6	9,137	-	-	-
Two-for-one common stock split	-	213	(213)	-	-	-
Dividends on common stock at \$5.42 per share	-	-	-	-	(58,959)	(58,959)
Dividends on preferred stock	-	-	-	-	(14,820)	(14,820)
Balance at December 31, 1997	130,482	451	342,570	79,441	7,965	560,909
Comprehensive loss:						
Net income – 1998	-	-	-	-	19,577	19,577
Change in net unrealized gain on investments classified as available for sale during the period	-	-	-	(82,538)	-	(82,538)
Total comprehensive loss	-	-	-	(82,538)	19,577	(62,961)
Issuance of common stock	-	7	7,652	-	-	7,659
Conversion of preferred stock	(3,075)	3	3,072	-	-	-
Retirement of common stock	-	(1)	(912)	-	-	(913)
Dividends on common stock at \$3.40 per share	-	-	-	-	(38,871)	(38,871)
Dividends on preferred stock	-	-	-	-	(13,019)	(13,019)
Balance at December 31, 1998	127,407	460	352,382	(3,097)	(24,348)	452,804
Comprehensive loss:						
Net loss – 1999	-	-	-	-	(75,135)	(75,135)
Change in net unrealized loss on investments classified as available for sale during the period	-	-	-	(45,410)	-	(45,410)
Total comprehensive loss	-	-	-	(45,410)	(75,135)	(120,545)
Issuance of common stock	-	-	30	-	-	30
One-for-four reverse common stock split	-	(345)	345	-	-	-
Retirement of common stock	-	(1)	(699)	-	-	(700)
Issuance of restricted stock awards	-	-	6	-	-	6
Forfeitures of restricted stock awards	-	-	(69)	-	-	(69)
Dividends on preferred stock	-	-	-	-	(6,454)	(6,454)
Balance at December 31, 1999	\$ 127,407	\$ 114	\$ 351,995	\$ (48,507)	\$ (105,937)	\$ 325,072

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
DYNEX CAPITAL, INC.

Years ended December 31, 1999, 1998 and 1997
(amounts in thousands except share data)

	1999	1998	1997
Operating activities:			
Net (loss) income	\$ (75,135)	\$ 19,577	\$ 73,998
Adjustments to reconcile net (loss) income to cash provided by operating activities:			
Provision for losses	16,154	6,421	4,933
Write-downs associated with winding down of commercial loan production	59,962	-	-
Net loss (gain) from sale of investments and trading activities	12,682	2,714	(11,584)
Gain on sale of loan production operations	(7,676)	-	-
Impairment charge and litigation provision - AutoBond	31,732	17,632	-
Equity in net (earnings) loss of Dynex Holding, Inc.	1,923	(2,456)	1,109
Extraordinary item – loss on extinguishment of debt	1,517	571	-
Amortization and depreciation	28,133	43,938	26,389
Net (increase) decrease in accrued interest, other assets and other liabilities	(15,257)	(4,471)	10,983
Net cash provided by operating activities	<u>54,035</u>	<u>83,926</u>	<u>105,828</u>
Investing activities:			
Collateral for collateralized bonds:			
Fundings of investments subsequently securitized	(627,290)	(1,857,617)	(2,302,831)
Principal payments on collateral	1,119,841	2,112,473	940,613
Decrease (increase) in accrued interest receivable	5,080	1,057	(10,316)
Net (increase) decrease in funds held by trustee	(1,051)	889	396
Net decrease (increase) in loans held for sale or securitization	84,762	(155,497)	29,767
Purchase of other investments	(33,348)	(38,192)	(50,525)
Payments received on other investments	11,254	16,977	18,547
Purchase of securities	(23,737)	(599,869)	(848,663)
Payments received on securities	79,009	122,693	62,184
Proceeds from sales of securities	61,415	424,338	847,339
Investment in and advances to Dynex Holding, Inc.	(26,335)	(47,572)	(82,086)
Proceeds from sale of loan production operations	213,591	19,000	9,500
Capital expenditures	(281)	(402)	(2,094)
Net cash provided by (used for) investing activities	<u>862,910</u>	<u>(1,722)</u>	<u>(1,388,169)</u>
Financing activities:			
Collateralized bonds:			
Proceeds from issuance of bonds	1,069,048	1,817,179	2,400,191
Principal payments on bonds	(1,091,216)	(2,066,915)	(919,885)
Increase (decrease) in accrued interest payable	3,677	(262)	2,945
Proceeds from issuance of senior notes	-	-	98,223
Repayment of senior notes	(17,833)	(11,750)	(3,000)
(Repayment of) proceeds from recourse debt borrowings, net	(851,771)	252,554	(256,660)
Net proceeds from issuance of stock	30	7,659	42,034
Retirement of common stock	(700)	(913)	-
Dividends paid	(9,682)	(68,155)	(70,520)
Net cash (used for) provided by financing activities	<u>(898,447)</u>	<u>(70,603)</u>	<u>1,293,328</u>
Net increase in cash	18,498	11,601	10,987
Cash at beginning of period	30,103	18,502	7,515
Cash at end of period	<u>\$ 48,601</u>	<u>\$ 30,103</u>	<u>\$ 18,502</u>

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.

December 31, 1999, 1998 and 1997
(amounts in thousands except share data)

NOTE 1 – BASIS OF PRESENTATION

Basis of Presentation

The consolidated financial statements include the accounts of Dynex Capital, Inc. and its qualified REIT subsidiaries (together, “Dynex REIT”). The loan production operations are primarily conducted through Dynex Holding, Inc. (“DHI”), a taxable affiliate of Dynex REIT. Dynex REIT owns all the outstanding non-voting preferred stock of DHI which represents a 99% economic ownership interest in DHI. Prior to December 1998, Dynex REIT had consolidated DHI for financial reporting purposes. The common stock of DHI represents a 1% economic ownership of DHI and is owned by certain officers of Dynex REIT. In light of these factors, DHI is accounted for under a method similar to the equity method. Dynex REIT has revised the accompanying consolidated statement of operations for 1997 to give retroactive effect to the change in accounting method during 1998. The accounting change had no impact on net income. Under the equity method, Dynex REIT’s original investment in DHI is recorded at cost and adjusted by Dynex REIT’s share of earnings or losses and decreased by dividends received. References to the “Company” mean Dynex Capital, Inc., its consolidated subsidiaries, and DHI and its consolidated subsidiaries. All significant intercompany balances and transactions with Dynex REIT’s consolidated subsidiaries have been eliminated in consolidation of Dynex REIT.

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The financial statements do not include any adjustments that might result from the outcome of any uncertainties described herein.

Significant Risks and Uncertainties

The Company’s business strategy has historically relied on access to financing sources such as warehouse lines of credit and repurchase agreements, and the asset-backed securities market, to finance its activities. During 1999, the Company’s access to these sources of financing was substantially impaired due in part to market perception of specialty finance companies that resulted from the disruption in the fixed income market in late 1998. As a result of this environment, the Company sold both its manufactured housing lending operations and model home purchase/leaseback business during 1999, and decided not to extend the forward commitments on commercial mortgage loans. In addition, in lieu of securitization, the Company decided to sell as whole loans its commercial loans held in inventory. The sale of the two production operations will significantly lower the Company’s capital requirements and will reduce the need for short-term financing. As a result of the decision not to extend the forward commitments on commercial mortgage loans and the related decision to sell (versus securitize) the commercial mortgage loans in inventory as whole loans, the Company recorded a writedown in the fourth quarter of 1999 of \$54.6 million. On a longer-term basis, competitive pressures, including competing against larger companies which generally have significantly lower costs of capital and access to the financing sources, the lack of ability to obtain critical lending sources to finance its production operations, and the lack of ability to access the capital markets as a long-term source of financing in a cost effective manner, are expected to continue to hamper the Company’s ability to compete profitably in the marketplace for the foreseeable future.

The Company has recourse debt of approximately \$537 million as of December 31, 1999, of which \$425 million comes due in 2000 (see Note 7, Recourse Debt). Given the Company’s operating performance during 1999 and the recent jury verdict in the litigation with AutoBond Acceptance Corporation as discussed in Note 14, Litigation, the Company’s access to additional credit has been limited, and there is generally less willingness of the Company’s current lenders to grant extensions. In addition, the Company is in violation of certain covenants in two of its warehouse lines of credit and the 1994 Senior Notes, principally related to minimum senior unsecured ratings and minimum net worth requirements, and the receipt of a going concern opinion from its auditors. The Company has not received waivers for these covenant violations, and, as a result, certain lenders could accelerate the debt as due and payable upon written notice. As of April 14, 2000, no lender has accelerated such debt.

As of April 14, 2000, the aggregate amount due under the two warehouse lines of credit was \$262.4 million, collateralized by loans with an unpaid principal balance of \$352.2 million, and cash reserves of \$8.4 million. Substantially all collateral pledged under these lines is held for sale. No assurance can be given, however, that any sales will ultimately be consummated.

The senior unsecured notes due July 2002, with an outstanding balance of \$97.3 million at December 31, 1999, contain covenants which provide for the acceleration of amounts outstanding should Dynex REIT default under other credit agreements in amounts in excess of \$10 million, and such amounts outstanding under the other credit agreements are accelerated by the respective lender.

As of April 14, 2000, the Company also has \$74.7 million outstanding under repurchase agreements with substantially one counterparty, which amount is collateralized with collateral having a current estimated market value of \$91.1.

As discussed in Note 14, Litigation, on March 9, 2000, a jury in the litigation with AutoBond Acceptance Corporation (“AutoBond”) returned a verdict in favor of AutoBond, and awarded \$18.7 million in direct lost profits and \$50.5 million in lost future profits to AutoBond. On April 17, 2000, based on motions filed by the Company, the judge presiding over the matter in Travis County proposed a judgement of approximately \$27 million (which includes estimated prejudgment interest) in lieu of the approximate \$69 million jury verdict. As a result, the Company recorded a litigation provision of \$27.0 million. The charge was reflected in impairment charges and litigation provision in the accompanying financial statements.

Reclassifications

Certain reclassifications have been made to the financial statements for the years ended December 31, 1998 and 1997 to conform to the December 31, 1999 presentation.

Stock Splits

On May 5, 1997, Dynex REIT completed a two-for-one common stock split. On July 26, 1999, Dynex REIT completed a one-for-four reverse common stock split. All references to the per share amounts in the accompanying consolidated financial statements and related notes have been restated to reflect both stock splits.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Federal Income Taxes

Dynex REIT has elected to be taxed as a real estate investment trust (“REIT”) under the Internal Revenue Code. As a result, Dynex REIT generally will not be subject to federal income taxation at the corporate level to the extent that it distributes at least 95 percent of its taxable income to its shareholders within the proscribed period and complies with certain other requirements. No provision has been made for income taxes for Dynex Capital, Inc. and its qualified REIT subsidiaries in the accompanying consolidated financial statements, as Dynex REIT believes it has met or will meet the prescribed requirements.

Investments

Pursuant to the requirements of Statement of Financial Accounting Standards No. 115 (“FAS No. 115”), “Accounting for Certain Investments in Debt and Equity Securities,” Dynex REIT is required to classify certain of its investments as either trading, available-for-sale or held-to-maturity. Dynex REIT has classified collateral for collateralized bonds and securities as available-for-sale. These investments are therefore reported at fair value, with unrealized gains and losses excluded from earnings and reported as accumulated other comprehensive income. Any decline in the fair value of an investment below its amortized cost which is deemed to be other than temporary is charged to earnings. The basis of any securities sold is computed using the specific identification method. Collateral for collateralized bonds can be sold only subject to the lien of the respective collateralized bond indenture, unless the related bonds have been redeemed.

Collateral for Collateralized Bonds. Collateral for collateralized bonds consists of securities which have been pledged to secure collateralized bonds. These securities are primarily backed by single family, multifamily and commercial properties and installment loans on manufactured housing. Substantially all of the collateral for collateralized bonds is pledged to secure non-recourse debt in the form of collateralized bonds issued by limited-purpose finance subsidiaries and is not available for the satisfaction of general claims of Dynex REIT. As the collateralized bonds are non-recourse to Dynex REIT, Dynex REIT’s exposure to loss on the assets pledged as collateral for collateralized bonds is generally limited to the amount of collateral pledged to the collateralized bonds in excess of the amount of the collateralized bonds issued.

Securities. Securities consist primarily of fixed-rate funding notes and securities secured by fixed-rate automobile installment contracts originated by AutoBond (“Funding Notes” and “Securities”), adjustable-rate mortgage (“ARM”) securities, fixed-rate mortgage securities, mortgage derivative securities and mortgage residual interests.

Other Investments. Other investments consist primarily of property tax receivables and an installment note receivable received in connection with the sale of the Company's single family mortgage operations in May 1996. Other investments are carried at their amortized cost basis.

Loans Held for Sale or Securitization

Loans held for sale or securitization at December 31, 1999 primarily include first mortgage loans secured by multifamily and commercial properties. These loans are considered held for sale, and accordingly are carried at the lower of cost or market.

Loans held for sale or securitization at December 31, 1998 included first mortgage loans secured by multifamily and commercial properties, and installment loans secured by manufactured housing. At December 31, 1998, these loans were held for securitization as collateral for collateralized bonds and were carried at amortized cost. Premiums paid or discounts obtained on these loans were deferred as an adjustment to the carrying value of the loans. Deferred hedging gains or losses, if any, were netted against the outstanding asset balances.

Construction loans on multifamily properties are also included in loans held for sale or securitization. Such loans are carried at the balance funded to date. Interest earned on these loans is capitalized and included as a component of the amount funded until construction is completed and the property is stabilized.

Price Premiums and Discounts

Price premiums and discounts on investments and obligations are amortized into interest income or expense, respectively, over the life of the related investment or obligation using a method that approximates the effective yield method.

Deferred Issuance Costs

Costs incurred in connection with the issuance of collateralized bonds and unsecured notes are deferred and amortized over the estimated lives of their respective debt obligations using a method that approximates the effective yield method.

Derivative Financial Instruments

Dynex REIT may enter into interest rate swap agreements, interest rate cap agreements, interest rate floor agreements, financial forwards, financial futures and options on financial futures ("Interest Rate Agreements") to manage its sensitivity to changes in interest rates. These Interest Rate Agreements are intended to provide income and cash flow to offset potential reduced net interest income and cash flow under certain interest rate environments. At trade date, these instruments are designated as either hedge positions or trade positions.

For Interest Rate Agreements designated as hedge instruments, Dynex REIT evaluates the effectiveness of these hedges periodically against the financial instrument being hedged under various interest rate scenarios. The revenues and costs associated with interest rate swap agreements are recorded as adjustments to interest income or expense on the asset or liability being hedged. For interest rate cap agreements, the amortization of the cost of the agreements is recorded as a reduction in the net interest income on the related investment. The unamortized cost is included in the carrying amount of the related investment. Revenues or cost associated with futures and option contracts are recognized in income or expense in a manner consistent with the accounting for the asset or liability being hedged. Amounts payable to or receivable from counterparties are included in the financial statement line of the item being hedged. Interest Rate Agreements that are hedge instruments and hedge an available for sale investment which is carried at its fair value are also carried at fair value, with unrealized gains and losses reported as accumulated other comprehensive income.

As a part of Dynex REIT's interest rate risk management process, Dynex REIT may be required periodically to terminate hedge instruments. Any realized gain or loss resulting from the termination of a hedge is amortized into income or expense of the corresponding hedged instrument over the remaining period of the original hedge or hedged instrument as a yield adjustment.

If the underlying asset, liability or commitment is sold or matures, or the criteria that was executed at the time the hedge instrument was entered into no longer exists, the Interest Rate Agreement is no longer accounted for as a hedge. Under these circumstances, the accumulated change in the market value of the hedge is recognized in current income to the extent that the effects of interest rate or price changes of the hedged item have not offset the hedge results.

Dynex REIT may also enter into forward delivery contracts and interest rate futures and options contracts for hedging interest rate risk associated with commitments made to fund loans. Gains and losses on these contracts are deferred as an adjustment to the carrying value of the related loans until the loan has been funded and accounted for consistent with the accounting of the underlying loan, or are recognized if the associated forward contract expires or is otherwise terminated.

For Interest Rate Agreements entered into for trading purposes, realized and unrealized changes in fair value of these instruments are recognized in the consolidated statements of operations as trading activities in the period in which the changes occur or when such trade instruments are settled. Amounts payable to or receivable from counterparties, if any, are included on the consolidated balance sheets in accrued expenses and other liabilities.

Cash

Approximately \$31,302 and \$24,437 of cash at December 31, 1999 and 1998, respectively, is either held as collateral for outstanding letters of credit; is held in trust to cover losses not otherwise covered by insurance; or is otherwise restricted for the payment of premiums on various insurance policies related to certain securities.

Net Income Per Common Share

Net income per common share is presented on both a basic net income per common share and diluted net income per common share basis. Diluted net income per common share assumes the conversion of the convertible preferred stock into common stock, using the if-converted method, and stock appreciation rights, using the treasury stock method, but only if these items are dilutive. As a result of the two-for-one split in May 1997 and the one-for-four reverse split in July 1999 of the Dynex REIT's common stock, the preferred stock is convertible into one share of common stock for two shares of preferred stock.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 revenue and expenses during the reported period. Actual results could differ from those estimates. The primary estimates inherent in the accompanying consolidated financial statements are discussed below.

Fair Value. Dynex REIT uses estimates in establishing fair value for its financial instruments. Estimates of fair value for financial instruments may be based on market prices provided by certain dealers. Estimates of fair value for certain other financial instruments are determined by calculating the present value of the projected cash flows of the instruments using appropriate discount rates, prepayment rates and credit loss assumptions. The discount rates used are based on management's estimates of market rates. Estimates of fair value for other financial instruments are based primarily on management's judgment. Since the fair value of Dynex REIT's financial instruments is based on estimates, actual gains and losses recognized may differ from those estimates recorded in the consolidated financial statements. The fair value of all on-and-off-balance sheet financial instruments is presented in Note 8.

Allowance for Losses. As discussed in Note 5, Dynex REIT has credit risk on certain investments in its portfolio. An allowance for losses has been estimated and established for current expected losses based on management's judgment. The allowance for losses is evaluated and adjusted periodically by management based on the actual and projected timing and amount of probable credit losses, as well as industry loss experience. Provisions made to increase the allowance related to credit risk are presented as provision for losses in the accompanying consolidated statements of operations. Dynex REIT's actual credit losses may differ from those estimates used to establish the allowance.

Derivative and Residual Securities. Income on certain derivative and residual securities is accrued using the effective yield method based upon estimates of future cash flows to be received over the estimated remaining lives of the related securities. Reductions in carrying value are made when the total projected cash flow is less than the Company's basis, based on either the dealers' prepayment assumptions or, if it would accelerate such adjustments, management's expectations of interest rates and future prepayment rates. In some cases, derivative and residual securities may also be placed on non-accrual status.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS No. 133"). FAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variable cash flows of a forecasted transaction, or (c) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security, or a foreign-currency-denominated forecasted transaction. In June 1999, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 137,

“Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133” (“FAS No. 137”). FAS No. 137 amends FAS No. 133 to defer its effective date to all fiscal quarters of all fiscal years beginning after June 15, 2000. The Company is in the process of determining the impact of adopting FAS No. 133.

NOTE 3 - COLLATERAL FOR COLLATERALIZED BONDS, SECURITIES AND OTHER INVESTMENTS

The following table summarizes Dynex REIT’s amortized cost basis and fair value of investments classified as available-for-sale, as of December 31, 1999 and 1998, and the related average effective interest rates:

	1999		1998	
	Fair Value	Effective Interest Rate	Fair Value	Effective Interest Rate
Collateral for collateralized bonds:				
Amortized cost	\$ 3,752,702	7.8%	\$ 4,288,520	7.5%
Allowance for losses	(15,299)		(16,593)	
Amortized cost, net	3,737,403		4,271,927	
Gross unrealized gains	34,198		67,236	
Gross unrealized losses	(70,887)		(45,635)	
	\$ 3,700,714		\$ 4,293,528	
Securities:				
Funding Notes and Securities	\$ 94,890	6.8%	\$ 122,009	8.0%
Adjustable-rate mortgage securities	18,047	7.0%	58,935	6.2%
Fixed-rate mortgage securities	9,861	13.5%	28,851	8.3%
Derivative and residual securities	18,421	1.5%	33,480	2.9%
Other securities	-	-	28,153	7.5%
	141,219		271,428	
Allowance for losses	(1,690)		(2,746)	
Amortized cost, net	139,529		268,682	
Gross unrealized gains	1,353		1,566	
Gross unrealized losses	(13,171)		(26,264)	
	\$ 127,711		\$ 243,984	

Collateral for collateralized bonds. Collateral for collateralized bonds consists primarily of securities backed by adjustable-rate and fixed-rate mortgage loans secured by first liens on single family housing, fixed-rate loans on multifamily and commercial properties and manufactured housing installment loans secured by either a UCC filing or a motor vehicle title. All collateral for collateralized bonds is pledged to secure repayment of the related collateralized bonds. All principal and interest (less servicing-related fees) on the collateral is remitted to a trustee and is available for payment on the collateralized bonds.

During 1999, Dynex REIT securitized \$2.3 billion of collateral, through the issuance of three series of collateralized bonds. The collateral securitized primarily included manufactured housing loans, and the resc securitization of previously securitized single family mortgage loans pursuant to a call feature in the Company’s prior securitizations. The securitizations were accounted for as financing of the underlying collateral pursuant to Statement of Accounting Standards No. 125, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities” (“FAS No. 125”), as Dynex REIT retains call rights which are substantially in excess of a clean-up call as defined by this accounting standard.

The components of collateral for collateralized bonds at December 31, 1999 and 1998 are as follows:

	1999	1998
Collateral, net of allowance	\$ 3,670,570	\$ 4,161,000
Funds held by trustees	2,707	1,656
Accrued interest receivable	22,754	27,834
Unamortized premiums and discounts, net	41,372	81,437
Unrealized (loss) gain, net	(36,689)	21,601
	\$ 3,700,714	\$ 4,293,528

Securities. Securities consist of Funding Notes and Securities as defined in Notes 2, ARM securities consist of mortgage certificates secured by ARM loans. Fixed-rate mortgage securities consist of mortgage certificates secured by mortgage loans that have a fixed rate of interest for at least one year from the balance sheet date. Derivative securities are classes of collateralized bonds, mortgage pass-through certificates or mortgage certificates that pay to the holder substantially all interest (i.e., an interest-only security), or substantially all principal (i.e., a principal-only security). Residual interests represent the right to receive the excess of (i) the cash flow from the collateral pledged to secure related mortgage-backed securities, together with any reinvestment income thereon, over (ii) the amount required for principal and interest payments on the mortgage-backed securities or repurchase arrangements, together with any related administrative expenses. Other securities primarily consist of a corporate bond at December 31, 1998.

Other investments. Other investments primarily include property tax receivables and an installment note receivable in connection with the sale of the Company's single family mortgage operations in May 1996.

Sale of investments. Proceeds from sales of securities totaled \$61,415, \$424,338, and \$847,339 in 1999, 1998 and 1997, respectively. Gross gains of \$285, \$8,481, and \$2,743 and gross losses of \$9,598, \$8,532, and \$2,163 were realized on those sales in 1999, 1998 and 1997, respectively. Net (loss) gain on sale of investments and trading activities at December 31, 1999 also includes (i) realized losses of \$7,386 related to the sale of \$58,724 of commercial loans during the year ended December, 31, 1999 and (ii) realized gains of \$4,176 on various derivative trading positions entered into during the year ended December 31, 1999. At December 31, 1999, the Company had no open derivative trading positions outstanding,

In 1999, Dynex REIT recorded an impairment charge of \$4,732 relating to the Funding Notes and Securities held by the Company at December 31, 1999. In 1998, Dynex REIT recorded an impairment charge of \$17,632 relating to the Funding Notes, a senior unsecured convertible note acquired from AutoBond in June 1998 and certain equity securities of AutoBond held by the Company at December 31, 1998.

NOTE 4 – LOANS HELD FOR SALE OR SECURITIZATION

The following table summarizes Dynex REIT's loans held for sale or securitization at December 31, 1999 and 1998, respectively.

	1999	1998
Secured by multifamily and commercial properties	\$ 234,593	\$ 160,101
Secured by manufactured homes	2,852	197,076
Secured by single family residential properties	629	1,243
	238,074	358,420
Deferred hedging costs	3,496	52,355
Net discount	(8,744)	(21,014)
Allowance for losses	(442)	(979)
Total loans held for sale or securitization	\$ 232,384	\$ 388,782

As of December 31, 1999 approximately 50% of the multifamily and commercial loans held for sale or securitization are located in Louisiana, Texas, California and Florida.

The Company funded loans with an aggregate principal balance of \$706,636 and \$1,150,271 during 1999, and 1998, respectively. Included in these amounts are \$136,682, and \$228,613 of multifamily construction loans and tax exempt bonds closed during the years ended December 31, 1999, and 1998, respectively. Only the amount drawn on the construction loans of \$115,515 and \$46,146

is included in the balance of the loans held for sale or securitization at December 31, 1999 and 1998, respectively. Additionally, Dynex REIT purchased loans on a bulk basis, principally single family ARM loans, totaling \$562,045 in 1998. The Company made no bulk loan purchases in 1999.

In the fourth quarter of 1999, the Company decided not to extend the forward commitments on commercial mortgage loans and to sell (versus securitize) the commercial mortgage loans held in inventory as whole loans. Accordingly, the Company reclassified loans with a principal balance of \$261,925 from held for securitization to held for sale, and recognized a loss of \$31,597 to adjust the carrying value of these loans to the lower of cost or market. The reclassification was necessary as the Company no longer had the intent nor the ability to hold such loans to maturity. The Company wrote-off \$28,365 of previously deferred hedging costs related to the expiration of the forward commitments to fund \$255,577 of multifamily and commercial and multifamily loans. The Company currently has commitments outstanding to fund multifamily loans of \$17.7 million, and has remaining construction draw commitments of \$8.3 million. The charges relating to exiting these operations have been included in “writedowns associated with commercial production operations” in the accompanying financial statements.

NOTE 5 - ALLOWANCE FOR LOSSES

The following table summarizes the activity for the allowance for losses on investments for the years ended December 31, 1999, 1998 and 1997:

	1999	1998	1997
Allowance at beginning of year	\$ 20,370	\$ 30,270	\$ 39,781
Provision for losses	16,154	6,421	4,933
Credit losses, net of recoveries	(19,040)	(16,321)	(14,444)
Allowance at end of year	\$ 17,484	\$ 20,370	\$ 30,270

Collateral for collateralized bonds. Dynex REIT has exposure to credit risk retained on loans that it has securitized through the issuance of collateralized bonds. The aggregate loss exposure is generally limited to the amount of collateral in excess of the related investment-grade collateralized bonds issued (commonly referred to as “overcollateralization”), excluding price premiums and discounts and hedge gains and losses. The allowance for losses on the overcollateralization totaled \$15,299 and \$16,593 at December 31, 1999 and 1998 respectively, and is included in collateral for collateralized bonds in the accompanying consolidated balance sheets. Overcollateralization amounted to \$229,328 and \$206,779 at December 31, 1999 and 1998, respectively, and \$179,438 and \$152,248, at December 31, 1999 and 1998, respectively, net of the allowance for losses, collateral discounts, and third party loss reimbursement guarantees.

Securities. On certain securities collateralized by mortgage loans purchased by Dynex REIT for which mortgage pool insurance is used as the primary source of credit enhancement, Dynex REIT has limited exposure to certain credit risks such as fraud in the origination and special hazards not covered by such insurance. An allowance was established based on the estimate of losses at the time of securitization. The allowance for losses for securities is \$1,690 and \$2,746 at December 31, 1999 and 1998, respectively, and is included in securities in the accompanying consolidated balance sheets.

Other investments. Dynex REIT has established reserves for potential losses for property tax receivables totaling \$53 at both December 31, 1999 and 1998. This amount excludes the difference between what the respective property owners owe satisfy their tax obligation, and the Company’s basis in such property tax receivables. Such differences were \$6,968 and \$89 at December 31, 1999 and 1998, respectively.

Loans held for sale or securitization. Dynex REIT has established reserves for potential losses for the loans held for sale or securitization totaling \$442 and \$979 at December 31, 1999 and 1998, respectively.

NOTE 6 - NON-RECOURSE DEBT

Dynex REIT, through limited-purpose finance subsidiaries, has issued non-recourse debt in the form of collateralized bonds. Each series of collateralized bonds may consist of various classes of bonds, either at fixed or variable rates of interest. Payments received on the collateral for collateralized bonds and any reinvestment income thereon are used to make payments on the collateralized bonds (see Note 3). The obligations under the collateralized bonds are payable solely from the collateral for collateralized bonds and are otherwise non-recourse to Dynex REIT. The maturity of each class is directly affected by the rate of principal prepayments on the related collateral. Each series is also subject to redemption according to specific terms of the respective indentures, generally when the

remaining balance of the bonds equals 35% or less of the original principal balance of the bonds. As a result, the actual maturity of any class of a collateralized bonds series is likely to occur earlier than its stated maturity.

Dynex REIT may retain certain classes of collateralized bonds issued, financing these retained collateralized bonds through a combination of repurchase agreements and equity. Total retained bonds at December 31, 1999 and 1998 were \$239,079 and \$375,108, respectively.

The components of collateralized bonds along with certain other information at December 31, 1999 and 1998 are summarized as follows:

	1999		1998	
	Bonds Outstanding	Range of Interest Rates	Bonds Outstanding	Range of Interest Rates
Variable-rate classes	\$ 1,968,915	5.8% - 9.1%	\$ 3,028,108	5.1% - 7.0%
Fixed-rate classes	1,315,944	6.2% - 11.5%	630,074	6.3% - 11.5%
Accrued interest payable	9,364		5,687	
Deferred bond issuance costs	(10,818)		(6,880)	
Unamortized net (discount) premium	(1,027)		8,327	
	\$ 3,282,378		\$ 3,665,316	
Range of stated maturities	2009-2033		2009-2032	
Number of series	27		33	

The variable rate classes are based on one-month London InterBank Offered Rate (LIBOR). The average effective rate of interest expense for non-recourse debt was 6.2%, 6.4%, and 6.7% for the years ended December 31, 1999, 1998 and 1997, respectively.

NOTE 7 - RECOURSE DEBT

Dynex REIT utilizes repurchase agreements, notes payable and secured credit facilities (together, "recourse debt") to finance certain of its investments. The following table summarizes Dynex REIT's recourse debt outstanding and the weighted-average annual rates at December 31, 1999 and 1998:

	1999			1998		
	Amount Outstanding	Weighted-Average Annual Rate	Market Value of Collateral	Amount Outstanding	Weighted-Average Annual Rate	Market Value of Collateral
Recourse debt secured by:						
Collateralized bonds	\$ 144,746	6.68%	\$ 173,278	\$ 298,695	6.01%	\$ 348,494
Securities	66,090	8.70%	114,641	192,706	6.53%	245,375
Other investments	31,498	8.47%	36,614	142,883	6.20%	159,377
Loans held for sale or securitization	183,901	7.93%	257,739	250,589	7.19%	334,855
Other assets	990	7.42%	895	2,557	7.46%	4,520
	<u>427,225</u>		<u>583,167</u>	<u>887,430</u>		<u>1,092,621</u>
Unsecured debt:						
7.875% senior notes	96,361	7.88%	-	98,718	7.88%	-
Series B 10.03% senior notes	13,512	10.03%	-	26,116	10.03%	-
Series A 9.56% senior notes	-	-	-	2,969	9.56%	-
Bank credit facility	-	-	-	17,500	8.03%	-
	\$ 537,098		\$ 583,167	\$ 1,032,733		\$ 1,092,621

Secured Debt. At December 31, 1999 and 1998, recourse debt consisted of \$163,045 and \$529,067, respectively, of repurchase agreements secured by investments, \$263,190 and \$355,805, respectively, outstanding under secured credit

facilities which are secured by loans held for sale or securitization, securities and other investments, and \$990 and \$2,557, respectively, of amounts outstanding under a capital lease. At December 31, 1999, substantially all recourse debt in the form of repurchase agreements had maturities within sixty days and bear interest at rates indexed to LIBOR. If the counterparty to the repurchase agreement fails to return the collateral, the ultimate realization of the security by Dynex REIT may be delayed or limited. The excess market value of the assets securing Dynex REIT's repurchase obligations at December 31, 1999 did not exceed 10% of shareholders' equity for any of the individual counterparties with whom Dynex REIT had contracted these agreements.

At December 31, 1999, Dynex REIT had four committed secured credit facilities aggregating \$698,662 to finance the funding of loans and securities, which expire prior to December 31, 2000. The following table summarizes the material terms of these facilities:

Facility	Outstanding Balance	Maturity Date	Eligible Collateral	Range of Interest Rates
\$195,000 secured credit facility agented by Chase Bank of Texas	\$ 111,600 ⁽¹⁾	May 29, 2000	Loans held for sale, property tax receivables	Various, ranging from LIBOR plus 1.375% -2.50%
\$400,000 secured credit facility with Morgan Stanley Mortgage Capital, Inc.	83,600	April 28, 2000	Loans held for sale	LIBOR plus 1.25% and 1.50%
\$100,000 secured credit facility with Daiwa Finance Corp.	47,800	May 10, 2000	Funding Notes and Securities	LIBOR plus 3.00%
\$3,700 secured credit facility with Residential Funding Corporation	3,700	December 15, 2000	Other investments	LIBOR plus 2.50%
	\$ 246,700			

(1) The \$195,000 secured credit facility agented by Chase Bank of Texas includes a subline in the amount of \$79,052 for the issuance of letters of credit to facilitate the issuance of tax-exempt multifamily housing bonds as discussed in Note 13. As of December 31, 1999, \$79,052 of letters of credit had been issued under the subline. Such amount is not included in the \$111,600 balance outstanding included in the table above.

For the credit lines expiring on April 28, 2000 and May 29, 2000, Dynex REIT is seeking to sell a substantial portion of the associated collateral by the respective maturity dates. However, it is unlikely that Dynex REIT will be able to payoff such credit lines by the respective maturity dates, and there can be no assurances that the lenders will agree to any extensions. In the event that the lenders declare an Event of Default, the underlying credit line agreements provide for the liquidation of the pledged collateral. In such a scenario it is likely that the Company will suffer substantial losses on the sale of the collateral. For the credit line expiring May 10, 2000, Dynex REIT and the lender executed a letter of intent dated April 10, 2000 whereby the collateral currently pledged to the line is instead pledged to a senior/subordinate security structure. Under the terms of the letter, the lender will "purchase" the senior security, the proceeds of which are used to repay the remaining amount outstanding under the credit line. Dynex REIT will retain the subordinate class. The security will provide for the full amortization of the senior class before any cash flow is paid on the subordinate class. The above lines of credit include various representations and covenants. Dynex REIT has violated certain covenants on credit lines expiring on April 28, 2000 and May 29, 2000 relating primarily to minimum net worth, minimum senior unsecured ratings requirements and the receipt of a going concern opinion from its auditors. Dynex REIT has received waivers from the investment bank on the credit line expiring on April 28, 2000 for the minimum senior unsecured ratings and minimum net worth requirements. Dynex REIT has not received a waiver for the uncured covenant violation for the receipt of the going concern opinion. The investment bank has not notified the Company formally in writing as required by the loan agreement that it has (i) terminated its commitments to lend or (ii) declared all or a portion of the loan due and payable. Dynex REIT has not received waivers for any uncured covenant violations from the bank syndicate on the credit line expiring on May 29, 2000. The bank syndicate has not formally notified Dynex REIT in writing as required by the loan documentation, that it has (i) terminated its commitment to lend or (ii) declared all or a portion of the loan due and payable. The Company's recourse credit facilities generally contain cross-default provisions whereby a default under any one credit facility is a default under each of the other credit facilities.

In 1997, Dynex REIT entered into capital leases for financing its furniture and computer equipment. Interest expense on these capital leases was \$177, \$274 and \$52 for the years ended December 31, 1999, 1998 and 1997, respectively. The leases expire in 2002. The aggregate payments due under the capital leases for remaining three years after December 31, 1999 are \$573, \$317 and \$255, respectively.

Unsecured Debt. Since 1994, Dynex REIT has issued three series of unsecured notes payable totaling \$150 million. These notes payable had an outstanding balance at December 31, 1999 of \$110.8 million. The Company has \$97.3 million outstanding of its July 2002 senior notes (the "2002 Notes") and \$13.5 million outstanding on notes issued in September 1994 (the "1994 Notes"). During the year ended December 31, 1999, Dynex REIT extinguished \$2.75 million of the 2002 Notes resulting in a \$0.6 million extraordinary gain. Effective May 15, 1999, the Company amended the 1994 Notes. In return for certain covenant relief related to the fixed-charge coverage requirements of the 1994 Notes, the Company agreed to (i) convert the principal amortization of the 1994 Notes from annual to monthly and (ii) shorten the remaining principal amortization period from 30 months to 16 months. Monthly amortization for the 1994 Notes through August 2000 approximates \$1.7 million per month. The Company is in violation of certain covenants in the 1994 Notes including the minimum net worth requirement and the covenant requiring an unqualified audit opinion. The Company has not received waivers for these defaults; however, the holders of the 1994 Notes have not accelerated the remaining amounts due.

The 2002 Notes contain covenants which provide for the acceleration of amounts outstanding under the 2002 Notes should Dynex REIT default under other credit agreements in amounts in excess of \$10 million, and such amounts outstanding under the other credit agreements are accelerated by the respective lender.

NOTE 8 – FAIR VALUE AND ADDITIONAL INFORMATION ABOUT FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standard No. 107, "Disclosures about Fair Value of Financial Instruments" ("FAS No. 107") requires the disclosure of the estimated fair value of on-and off-balance-sheet financial instruments. The following table presents the amortized cost and estimated fair values of Dynex REIT's financial instruments as of December 31, 1999 and 1998:

	1999			1998		
	Notional Amount	Amortized Cost	Fair Value	Notional Amount	Amortized Cost	Fair Value
Recorded financial instruments:						
Assets:						
Collateral for collateralized bonds	\$ -	\$ 3,734,310	\$ 3,699,829	\$ -	\$ 4,267,268	\$ 4,293,159
Securities	-	135,431	126,675	-	263,708	243,589
Other investments	-	48,927	48,752	-	30,371	29,249
Loans held for sale or securitization	-	236,332	237,192	-	356,895	354,102
Interest rate cap agreements	1,364,000	7,190	1,920	1,599,000	9,634	764
Liabilities:						
Non-recourse debt	-	3,282,378	3,282,378	-	3,665,316	3,665,316
Recourse debt:						
Secured by collateralized bonds retained	-	144,746	144,746	-	298,695	298,695
Secured by investments	-	282,479	282,479	-	588,735	588,735
Unsecured	-	109,873	80,747	-	145,303	105,205
Off-balance sheet financial instruments:						
Options on futures contracts	-	-	-	700,000	4,589	2,441
Interest rate swap agreements	1,020,000	-	(1,259)	1,139,863	-	(3,699)
Commitments to fund loans	54,668	(3,948)	49,066	823,030	27,908	849,713

The fair value of collateral for collateralized bonds, securities, other investments, loans held for sale or securitization and interest rate cap agreements is based on actual market price quotes, or by determining the present value of the projected future cash flows using appropriate discount rates, credit losses and prepayment assumptions. Non-recourse debt and secured recourse debt are short-term borrowings that reprice frequently. Therefore, the carrying value approximates the fair value. For unsecured debt maturing in less than one year, carrying value approximates fair value. For unsecured debt with a

maturity of greater than one year, the fair value was determined by calculating the present value of the projected cash flows using appropriate discount rates. The fair value of the off-balance sheet financial instruments excluding the commitments to fund loans was determined from actual market quotes. The fair value of the commitments to fund loans was estimated assuming the loans were securitized at current market rates.

Derivative Financial Instruments Used for Interest Rate Risk Management

Dynex REIT may engage in derivative financial instrument activities for the purpose of interest rate risk management and yield enhancement. As of December 31, 1999, all of Dynex REIT's outstanding derivative financial positions were for interest rate risk management. For all derivative financial instruments, Dynex REIT has credit risk to the extent that the counterparties do not perform their obligation under the agreements. If one of the counterparties does not perform, Dynex REIT would not receive the cash to which it would otherwise be entitled under the conditions of the agreement.

Interest rate cap agreements. Dynex REIT has LIBOR and one-year Constant Maturity Treasury (CMT) index based interest rate cap agreements to limit its exposure to the lifetime interest rate caps on certain of its ARM securities and collateral for collateralized bonds. Under these agreements, the Company will receive additional cash flow should the related index increase above the contracted rates. Contract rates on these cap agreements range from 9.0% to 11.5%, with expiration dates ranging from 2001 to 2004.

Financial futures, forwards and options contracts. Dynex REIT may use financial futures, forward and option contracts to reduce exposure to the effect of changes in interest rates on funded loans, as well as those loans that Dynex REIT has committed to fund. As of December 31, 1999, Dynex REIT had outstanding commitments to fund multifamily and commercial loans of \$26,005 at fixed interest rates ranging from 6.69% to 7.90%. The multifamily and commercial commitments had original terms of not more than 18 months. Dynex REIT has deferred net hedging losses of \$186 at December 31, 1999. At December 31, 1999, there were no open financial futures, forward or options contracts to reduce exposure to the effect of changes in interest rates on these commitments.

Interest rate swap agreements. Dynex REIT may enter into various interest rate swap agreements to limit its exposure to changes in financing rates of collateral for collateralized bonds and certain securities. Dynex REIT has entered into a series of interest rate swap agreements which limits the increase in borrowing costs in any six-month period to 1% for \$1,020,000 notional amount of short-term borrowings. Pursuant to the terms of this agreement, Dynex REIT pays the lesser of current six-month LIBOR, or six-month LIBOR in effect 180-days prior plus 1%, and receives current 6month LIBOR. These agreements expire in 2001.

During 1999, Dynex REIT terminated interest rate swap agreements with a notional value of \$102,198. These interest rate swap agreements related to Prime rate-based ARM loans financed with LIBOR-based variable-rate collateralized bonds. Under the terms of the agreement, the Company received one-month LIBOR plus 2.65% and paid one-month average Prime rate in effect three months prior. The cost of terminating this agreement was \$750, which was deferred and is being recognized as a yield adjustment over the remaining life of the underlying collateral.

During 1998 and 1997, Dynex REIT entered into interest rate swap agreements with a notional balance of \$73,000 and \$25,134, respectively, related to tax-exempt bonds for which Dynex REIT facilitates the issuance. As the facilitator of the issuance of the bonds, Dynex REIT is required to pay interest due to the bondholders in excess of a fixed rate. The bonds are floating-rate based on the current weekly Bond Market Association ("BMA") index. During the fourth quarter of 1998, Dynex REIT terminated all of these agreements. The cost of terminating these agreements was \$3,419. The cost was deferred and is being amortized over the remaining life of the tax-exempt bonds. The amount remaining to be amortized at December 31, 1999 was \$3,310.

Derivative Financial Instruments Used for Other Than Risk Rate Management Purposes

The Company may enter into financial futures, forwards and options contracts to enhance the overall yield on its investment portfolio. Such derivative contracts are accounted for as trading positions, and generally are for terms of less than three months. The Company realized gross gains of \$4,160 and \$4,136 from these contracts in 1999 and 1998, respectively, primarily from premium income received on options contracts written. The Company realized gross losses of \$14 and \$5,565 from these contracts in 1999 and 1998, respectively. There were no open trading positions at December 31, 1999 and 1998.

NOTE 9 - SALE OF LOAN PRODUCTION OPERATIONS

On December 20, 1999, the Company sold its manufactured housing lending operations, which was operated through its affiliate, Dynex Financial, Inc., to a subsidiary of Bingham Financial Services Corporation (NYSE: BFSC) ("Bingham") for \$18,602. Under the terms of the sale, Bingham purchased all of the outstanding stock of Dynex Financial, Inc. and assets that constitute the manufactured housing lending and servicing operations, as well as unsecuritized loans which had been held in warehouse at the time of the sale. As a result of the sale, the Company recorded a net gain of \$1,540.

On November 10, 1999, the Company sold its model home purchase/leaseback operations and related assets, which were operated through its affiliate, Dynex Residential, Inc., to Residential Funding Corporation, an indirect subsidiary of General Motors Corporation for \$194,989. As a result of the sale, the Company recorded a net gain of \$6,136. The provisions of the sale included indemnification escrows and reserves amounting to \$3,000. These escrows and reserves will be released to the Company pursuant to various terms in the agreement over a period not to exceed 24 months.

NOTE 10 - EARNINGS PER SHARE

The following table reconciles the numerator and denominator for both the basic and diluted EPS for the years ended December 31, 1999, 1998 and 1997.

	1999		1998		1997	
	Income	Weighted-Average Number of Shares	Income	Weighted-Average Number of Shares	Income	Weighted-Average Number of Shares
Income before extraordinary item	\$(73,618)		\$ 20,148		\$ 73,998	
Extraordinary item - loss on extinguishment of debt	(1,517)		(571)		-	
Net income after extraordinary item	<u>(75,135)</u>		<u>19,577</u>		<u>73,998</u>	
Less: Dividends paid to preferred stock	(12,910)		(13,019)		(14,820)	
Basic	<u>(88,045)</u>	<u>11,483,977</u>	<u>6,558</u>	<u>11,436,599</u>	<u>59,178</u>	<u>10,757,845</u>
Effect of dividends and additional shares of preferred stock:						
Series A	-	-	-	-	3,948	738,353
Series B	-	-	-	-	5,500	1,034,737
Series C	-	-	-	-	-	-
Diluted	<u>\$(88,045)</u>	<u>11,483,977</u>	<u>\$ 6,558</u>	<u>11,436,599</u>	<u>\$ 68,626</u>	<u>12,530,935</u>
Earnings per share before extraordinary item:						
Basic EPS		<u>(\$7.53)</u>		<u>\$0.62</u>		<u>\$5.50</u>
Diluted EPS		<u>(\$7.53)</u>		<u>\$0.62</u>		<u>\$5.48</u>
Earnings per share after extraordinary item:						
Basic EPS		<u>(\$7.67)</u>		<u>\$0.57</u>		<u>\$5.50</u>
Diluted EPS		<u>(\$7.67)</u>		<u>\$0.57</u>		<u>\$5.48</u>
Reconciliation of anti-dilutive shares:						
Dividends and additional shares of preferred stock:						
Series A	\$ 3,063	654,531	\$ 3,111	660,812	\$ -	-
Series B	4,475	956,217	4,535	959,282	-	-
Series C	5,372	920,000	5,373	920,000	5,372	919,868
Expense and incremental shares of stock appreciation rights	-	28,931	929	15,226	2,019	51,849
	<u>\$ 12,910</u>	<u>2,559,679</u>	<u>\$ 13,948</u>	<u>2,555,320</u>	<u>\$ 7,391</u>	<u>971,717</u>

During 1999, Dynex REIT exercised its call rights on two series of previously issued collateralized bonds and re-securitized these two series along with six series of previously issued collateralized bonds redeemed in 1998. This re-securitization resulted in \$2,114 of additional costs in 1999. During 1998, Dynex REIT redeemed six series of previously issued collateralized bonds, which resulted in \$571 of additional costs related to such redemptions. In addition, Dynex REIT purchased \$2,750 of the 2002 Notes during 1999, which resulted in an extraordinary gain of \$597. As a result of these early redemptions, both the basic and diluted earnings per share were reduced by \$0.14 during 1999.

NOTE 11 - PREFERRED STOCK

The following table presents a summary of Dynex REIT's issued and outstanding preferred stock:

	Liquidation Preference Per Share	Dividends Per Share		
		1999	1998	1997
Series A 9.75% Cumulative Convertible Preferred Stock ("Series A")	\$24.00	\$ 1.17	\$ 2.37	\$ 2.71
Series B 9.55% Cumulative Convertible Preferred Stock ("Series B")	24.50	1.17	2.37	2.71
Series C 9.73% Cumulative Convertible Preferred Stock ("Series C")	30.00	1.46	2.92	2.92

Dynex REIT is authorized to issue up to 50,000,000 shares of preferred stock. For all series issued, dividends are cumulative from the date of issue and are payable quarterly in arrears. The dividends are equal, per share, to the greater of (i) the per quarter base rate of \$0.585 for Series A and Series B, and \$0.73 for Series C, or (ii) one half times the quarterly dividend declared on Dynex REIT's common stock. Two shares of Series A, Series B and Series C are convertible at any time at the option of the holder into one share of common stock. Each series is redeemable by Dynex REIT at any time, in whole or in part, (i) two shares of preferred stock for one share of common stock, plus accrued and unpaid dividends, provided that for 20 trading days within any period of 30 consecutive trading days, the closing price of the common stock equals or exceeds one-half of the issue price, or (ii) for cash at the issue price, plus any accrued and unpaid dividends.

In the event of liquidation, the holders of all series of preferred stock will be entitled to receive out of the assets of Dynex REIT, prior to any such distribution to the common shareholders, the issue price per share in cash, plus any accrued and unpaid dividends.

No shares of Series A, B or C preferred stock were converted during 1999.

The Company did not declare a dividend on its preferred stock during the third or fourth quarter of 1999. As of December 31, 1999, the total amount of dividends in arrears was \$6,456. Individually, the amount of dividends in arrears on the Series A, the Series B and the Series C was \$1,532 (\$1.17 per Series A share), \$2,238 (\$1.17 per Series B share) and \$2,686 (\$1.46 per Series C share), respectively.

NOTE 12 - EMPLOYEE BENEFITS

Stock Incentive Plan

Pursuant to the Company's 1992 Stock Incentive Plan, as amended on April 24, 1997 (the "Employee Incentive Plan"), the Company may grant to eligible employees stock options, stock appreciation rights ("SARs") and restricted stock awards. An aggregate of 2,400,000 shares of common stock is available for distribution pursuant to the Employee Incentive Plan. The Company may also grant dividend equivalent rights ("DERs") in connection with the grant of options or SARs. These SARs and related DERs generally become exercisable as to 20 percent of the granted amounts each year after the date of the grant. The Company expensed \$1,830 for SARs and DERs related to the Employee Incentive Plan during 1997, and there was no expense during 1999 and 1998. There were no stock options outstanding as of December 31, 1999, 1998 and 1997.

Stock Incentive Plan for Outside Directors

In 1995, Dynex REIT adopted a Stock Incentive Plan for its Board of Directors (the "Board Incentive Plan") with terms similar to the Employee Incentive Plan. On May 1, 1995, the date of the initial date of grant under the Board Incentive Plan, each member of the Board of Directors was granted 14,000 SARs. Each Board member has subsequently received a grant of 2,000 SARs on May 1, 1996, 1997, 1998 and 1999. The SARs granted on May 1, 1995 were fully vested on May 1, 1998. Each successive award will become exercisable as to 20% of the granted amounts each year after the date of grant. The maximum period in which any SAR may be exercised is 73 months from the date of grant. The maximum number of shares of common stock encompassed by the SARs granted under the Board Incentive Plan is 200,000. Dynex REIT expensed \$189 for SARs and DERs related to the Board Incentive Plan during 1997 and there was no expense during 1999 and 1998.

The following table presents a summary of the SARs activity for both the Employee Incentive Plan and the Board Incentive Plan.

	Years ended December 31,					
	1999		1998		1997	
	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
SARs outstanding at beginning of year	219,695	\$44.72	173,723	\$43.48	157,955	\$35.92
SARs granted	111,858	14.00	64,775	47.00	52,075	55.00
SARs forfeited	(33,316)	34.15	(5,303)	48.48	-	-
SARs exercised	(19,525)	10.86	(13,500)	28.16	(36,307)	27.28
SARs outstanding at end of year	278,712	33.33	219,695	\$44.72	173,723	\$43.48
SARs vested and exercisable	103,458	42.41	85,120	\$41.52	55,910	\$38.84

The Company adopted the disclosure-only option under Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("FAS No. 123"). If the fair value accounting provisions of FAS No. 123 had been adopted as of January 1, 1996 the pro forma effect on the 1999, 1998 and 1997 results would have been immaterial. The exercise price range for the SARs outstanding at December 31, 1999 was \$14.00-\$58.00 with a weighted-average exercise price of \$33.33 and a weighted-average contractual remaining life of 3 years.

Employee Savings Plan

The Company provides an Employee Savings Plan under Section 401(k) of the Internal Revenue Code. The Employee Savings Plan allows eligible employees to defer up to 12% of their income on a pretax basis. The Company matches the employees' contribution, up to 6% of the employees' eligible compensation. The Company may also make discretionary contributions based on the profitability of the Company. The total expense related to the Company's matching and discretionary contributions in 1999, 1998 and 1997 was \$541, \$497, and \$424, respectively. The Company does not provide post employment or post retirement benefits to its employees.

401(k) Overflow Plan

During 1997, the Company adopted a non-qualifying overflow plan which covers employees who have contributed to the Employee Savings Plan the maximum amount allowed under the Internal Revenue Code. The excess contributions are made to the overflow plan on an after-tax basis. However, the Company partially reimburses employees for the effect of the contributions being made on an after-tax basis. The Company matches the employee's contribution up to 6% of the employee's eligible compensation. The total expense related to the Company's reimbursements in 1999, 1998 and 1997 was \$60, \$56 and \$17, respectively.

NOTE 13 - COMMITMENTS AND CONTINGENCIES

The Company makes various representations and warranties relating to the sale or securitization of loans. To the extent the Company were to breach any of these representations or warranties, and such breach could not be cured within the allowable time period, the Company would be required to repurchase such loans, and could incur losses. In the opinion of management, no material losses are expected to result from any such representations and warranties.

The Company has made various representations and warranties relating to the sale of various production operations. To the extent the Company were to breach any of these representations or warranties, and such breach could not be cured within the allowable time period, the Company would be required to cover any loss and expenses up to certain limits. In the opinion of management, no material losses are expected to result from any such representations and warranties.

Dynex REIT facilitates the issuance of tax-exempt multifamily housing bonds, the proceeds of which are used to fund construction or moderate rehabilitation mortgage loans on multifamily properties. These tax-exempt bonds are sold to third party investors. Dynex REIT enters into various standby commitment and similar agreements whereby Dynex REIT is required to pay principal and interest to the bondholders in the event there is a payment shortfall from the construction proceeds, and is required to repurchase bonds if the bonds cannot be successfully marketed. Dynex REIT provided letters of credit to support its obligations in amounts equal \$95,730 and \$144,216 at December 31, 1999 and 1998, respectively. Dynex REIT is also party to various conditional bond repurchase obligation agreements which require Dynex REIT to repurchase bonds in the aggregate notional amount of \$167,700 by June 15, 2000. As support for its obligation to repurchase, Dynex REIT has posted fully cash-collateralized letters of credit totaling \$16,678, and esrowed cash of an additional \$15,832 and posted a \$5,000 sight draft surety bond. Such amounts are at risk should the Company fail on its repurchase obligation.

As of December 31, 1999, Dynex REIT is obligated under noncancelable operating leases with expiration dates through 2004. Rent expense under those leases was \$278, \$336, and \$295, respectively in 1999, 1998 and 1997. The future minimum lease payments under these noncancelable leases are as follows: 2000--\$642; 2001--\$659; 2002--\$677; 2003--\$696 and 2004--\$9.

NOTE 14 – LITIGATION

On February 8, 1999, AutoBond Acceptance Corporation (“AutoBond”), AutoBond Master Funding Corporation V (“Funding”), and its three principal common shareholders (collectively, the “Plaintiffs”) commenced an action in the District Court of Travis County, Texas (250th Judicial District) against the Company and James Dolph (collectively, the “Defendants”) alleging that the Company breached the terms of the Credit Agreement, dated June 9, 1998, by and among AutoBond, Funding and the Company. The terms of the Credit Agreement provided for the purchase by the Company of funding notes issued by Funding, and collateralized by automobile installment contracts (“Auto Contracts”) acquired by AutoBond. The Company suspended purchasing the funding notes in February 1999 on grounds that AutoBond and Funding had violated certain provisions of the Credit Agreement. The Plaintiffs also alleged that the Defendants conspired to misrepresent and mischaracterize AutoBond’s credit underwriting criteria and its compliance with such criteria with the intention of interfering and causing actual damage to AutoBond’s business, prospective business and contracts.

On August 26, 1999, the District Court of Travis County ordered AutoBond and Funding, through a temporary injunction action, to cooperate with the Company and permit the transfer of the servicing of the Auto Contracts from AutoBond to a third party servicer selected by the Company. The servicing was transferred on September 3, 1999.

On March 9, 2000, a jury in the AutoBond action returned a verdict in favor of the Plaintiffs, and awarded AutoBond and Funding \$18.7 million in direct lost profits and \$50.5 million in lost future profits, for a total of \$69.2 million. The Company filed on March 24, 2000 with the Court motions to set aside the verdict and to reduce the amount of the verdict, and on the same date, AutoBond filed a motion to the court to enter judgment. On April 17, 2000, in response to the various motions filed, the judge presiding over the matter in Travis County reduced the \$69.2 million verdict awarded by the jury to approximately \$27 million (which includes estimated prejudgment interest). As a result, the Company recorded a litigation provision of \$27.0 million for the amount of the reduced judgment. Should AutoBond not accept the proposed judgment, the judge has indicated that he will grant Dynex a new trial. Should AutoBond accept the judgment, the Company is evaluating its options in the matter, which may include the appeal of the verdict and the resulting judgment. Factors for the Company to consider include the potential inability of the Company to post the amount of appeal bond necessary to secure an appeal. Should Dynex REIT not be able to secure an appeal bond for the full amount of the proposed judgement of \$27 million, Texas State law would allow for Dynex REIT to present evidence to reduce the required amount of the appeal bond or to provide other collateral for the appeal. There can be no assurance that Dynex REIT will be allowed to post a reduced bond.

The Company is also subject to other lawsuits or claims which arise in the ordinary course of its business, some of which seek damages in amounts which could be material to the financial statements. Although no assurance can be given with respect to the ultimate outcome of any such litigation or claim, the Company believes the resolution of such lawsuits or claims will not have a material affect on the Company’s consolidated balance sheet, but could materially affect consolidated results of operations in a given year.

NOTE 15 - SUPPLEMENTAL CONSOLIDATED STATEMENTS OF CASH FLOWS INFORMATION

	Years ended December 31,		
	1999	1998	1997
Cash paid for interest	\$ 264,130	\$ 319,626	\$ 232,598
Supplemental disclosure of non-cash activities:			
Collateral for collateralized bonds owned subsequently securitized	\$ 1,607,891	\$ -	\$ 65,537
Securities owned subsequently securitized	\$ 4,986	\$ 257,959	\$ 311,117
Other investments owned subsequently securitized	\$ -	\$ 37,221	\$ -

NOTE 16 - RELATED PARTY TRANSACTIONS

Dynex REIT has a credit arrangement with DHI whereby DHI and any of DHI's subsidiaries can borrow funds from Dynex REIT to finance its production operations. Under this arrangement, Dynex REIT can also borrow funds from DHI. The terms of the agreement allow DHI and its subsidiaries to borrow up to \$50 million from Dynex REIT at a rate of Prime plus 1.0%. Dynex REIT can borrow up to \$50 million from DHI at a rate of one-month LIBOR plus 1.0%. This agreement has a one-year maturity which is extended automatically unless notice is received from one of the parties to the agreement within 30 days of the anticipated termination of the agreement. As of December 31, 1999 and 1998, net borrowings due to DHI under this agreement totaled \$26,720 and \$8,583, respectively. Net interest expense under this agreement was \$706, \$992 and \$462 for the years ended December 31, 1999, 1998 and 1997, respectively.

Dynex REIT also had a loan funding agreement with Dynex Financial, Inc. ("DFI"), an operating subsidiary of DHI, whereby Dynex REIT paid DFI on a fee plus cost basis for the origination of manufactured housing loans on behalf of Dynex REIT. During 1999, 1998 and 1997, Dynex REIT paid DFI \$12,369, \$15,771 and \$9,722, respectively under such agreement. This agreement was terminated as a result of the sale of the manufactured housing operations during 1999.

Dynex REIT had a funding agreement with Dynex Commercial, Inc. ("DCI"), an operating subsidiary of DHI, whereby Dynex REIT pays DCI a fee per loan originated purchased by Dynex REIT from DCI. Dynex REIT paid DCI \$2,147, \$4,753 and 1,694, respectively under this agreement for the years ended December 31, 1999, 1998 and 1997.

Dynex REIT had note agreements with Dynex Residential, Inc. ("DRI"), an operating subsidiary of DHI, whereby DRI and its subsidiaries could borrow up to \$287,000 from Dynex REIT on a secured basis to finance the acquisition of model homes from single-family home builders. The interest rate on the note was adjustable and was based on 30-day LIBOR plus 2.875%. During 1999, \$4,577 of the notes was assumed by SMFC Funding Corporation ("SMFC"), a subsidiary of DHI. The remainder of the notes were paid off at the time of the sale of DRI on November 10, 1999. The outstanding balance of the notes as of December 31, 1999 and 1998 was \$4,274 and \$159,377, respectively. Interest income recorded by Dynex REIT for the years ended December 31, 1999, 1998 and 1997 was \$12,793, \$11,971 and \$6,354, respectively.

Dynex REIT has entered into subservicing agreements with DCI, Dynex Commercial Services, Inc. ("DCSI"), DFI and GLS Capital Services, Inc. ("GLS") to service commercial, single family, consumer, manufactured housing loans and property tax receivables. For servicing the commercial loans, DCI or DCSI, as applicable, received an annual servicing fee of 0.02% of the aggregate unpaid principal balance of the loans. For servicing the single family mortgage, consumer and manufactured housing loans, DFI received annual fees ranging from sixty dollars (\$60) to one hundred forty-four dollars (\$144) per loan and certain incentive fees. The subservicing agreement with DFI was terminated due to the sale of DFI on December 20, 1999. For servicing the property tax receivables, GLS receives an annual servicing fee of 0.72% of the aggregate unpaid principal balance of the property tax receivables. Servicing fees paid by Dynex REIT under such agreements were \$2,873, \$1,061 and \$321 in 1999, 1998 and 1997, respectively.

NOTE 17- INVESTMENT IN AND ADVANCES TO DYNEX HOLDING, INC.

In 1998, Dynex REIT changed its method of accounting for its investment in DHI from the full consolidation method to a method that approximates the equity method. The accounting change had no impact on net income. For consistency

purposes, Dynex REIT has revised the 1997 financial statements to give retroactive effect to the change in accounting method.

Investments in and advances to DHI accounted for under a method similar to the equity method amounted to \$4,814 and \$169,384 at December 31, 1999 and 1998, respectively. The results of operations and financial position of DHI are summarized below:

Condensed Income Statement Information	Years ended December 31,		
	1999	1998	1997
Total revenues	\$ 40,710	\$ 30,126	\$ 17,338
Total expenses	42,653	27,645	18,458
Net income (loss)	(1,943)	2,481	(1,120)

Condensed Balance Sheet Information	December 31,	
	1999	1998
Total assets	\$ 36,822	\$ 196,324
Total liabilities	9,075	177,050
Total equity	27,747	19,274

NOTE 18– OTHER MATTERS

During the year ended December 31, 1999, the Company issued 2,084 shares of its common stock pursuant to its dividend reinvestment program for net proceeds of \$30.

The Company repurchased 66,100 shares of its common stock outstanding at an aggregate purchase price of \$700, or \$10.59 per share, during the year ended December 31, 1999. The Company has authorization to purchase an additional 848,900 shares of its common stock.

At the special meeting of shareholders, held on July 26, 1999, the shareholders approved an amendment to the Articles of Incorporation to effect a one-for-four reverse split of the issued and outstanding shares of the Company's \$0.01 par value common stock to holders of record on August 2, 1999. All references in the accompanying financial statements to the per share amounts and the number of shares of common stock, except for shares authorized, issued and outstanding for 1998 have been restated to reflect the reverse stock split.

DYNEX CAPITAL, INC.
SCHEDULE IV - MORTGAGE LOANS ON REAL ESTATE

December 31, 1999
(amounts in thousands except number of loans)

Description	Interest Rate	Final Maturity Date	Periodic Payment Terms	Prior Liens	Face Amount of Mortgages	Carrying Amount of Mortgage Loans	Principal Amount of Loans Subject to Delinquent Principal or Interest
First mortgage loans:							
<i>Single family residential</i>							
18 mortgages, original loan amounts ranging from \$46 to \$216	7.25% - 10.25%	Varies	-	\$ -	\$ -	\$ 1,493	\$ 69
<i>Commercial</i>							
<u>Office Building</u>							
St. Paul, Minnesota (1)	6.96%	October 1, 2008	Interest and principal monthly	-	41,500	14,729	-
Denver, Colorado (1)	8.30%	October 1, 2012	Interest and principal monthly	-	30,000	6,870	-
New Orleans, Louisiana	9.70%	April 1, 2001	Interest monthly	-	8,200	8,200	-
New Orleans, Louisiana	9.70%	April 1, 2001	Interest monthly	-	7,400	7,400	-
New Orleans, Louisiana	8.70%	April 1, 2001	Interest monthly	-	15,000	15,000	-
<u>Multifamily Residential</u>							
Baton Rouge, Louisiana	7.75%	March, 1 2016	Interest and principal monthly	-	8,075	7,297	-
Baton Rouge, Louisiana	7.75%	March, 1 2016	Interest and principal monthly	-	8,075	6,851	-
Garland, Texas	7.95%	May, 1 2017	Interest and principal monthly	-	11,750	11,693	-
Fredricksburg, Virginia	7.95%	August, 1 2017	Interest and principal monthly	-	5,290	5,276	-

DYNEX CAPITAL, INC.
SCHEDULE IV - MORTGAGE LOANS ON REAL ESTATE (CONTINUED)

December 31, 1999
(amounts in thousands except number of loans)

Description	Interest Rate	Final Maturity Date	Periodic Payment Terms	Prior Liens	Face Amount of Mortgages	Carrying Amount of Mortgage Loans	Principal Amount of Loans Subject to Delinquent Principal or Interest
Columbia, South Carolina	7.75%	January, 1 2009	Interest and principal monthly	-	4,876	4,837	-
Arvada, Colorado	7.95%	January, 1 2018	Interest and principal monthly	-	3,887	3,887	-
Concord, North Carolina	7.95%	June, 1 2017	Interest and principal monthly	-	3,795	3,779	-
Austin, Texas	8.15%	September, 1 2017	Interest and principal monthly	-	3,600	3,591	-
Oceanside, California	8.00%	April, 1 2009	Interest monthly	-	7,000	3,640	-
22 mortgages, original loan amounts ranging from \$115 to \$3,034	6.79% - 8.75%	Varies	-	-	-	30,524	-
						135,067	
Write-down to lower of cost or market						(14,221)	
Net premium/discount						(2,581)	
Allowance for loan losses						(26)	
Total mortgage loans on real estate						\$ 118,239	

(1) The Company owns a participation in this loan. The remaining amount of the loan was securitized in a commercial securitization completed by the Company in December 1998.

The loans in the table above are conventional mortgage loans secured by either single family and/or commercial properties with initial maturities ranging from 3 to 30 years. All of the loans above are fixed-rate. The Company believes that its mortgage pool insurance and allowance of \$26 are adequate to cover any exposure on delinquent mortgage loans. A summary of activity of the single family and commercial mortgage loans for the years ended December 31, 1999, 1998 and 1997 is as follows:

Balance at December 31, 1996	\$ 238,428
Mortgage loans funded	1,526,229
Collection of principal	(61,188)
Mortgage loans sold or securitized	(1,544,844)
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Balance at December 31, 1997	158,625
Mortgage loans funded or purchased	1,164,512
Collection of principal	(118,583)
Mortgage loans securitized	(1,070,186)
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Balance at December 31, 1998	134,368
Mortgage loans funded or purchased	183,386
Collection of principal	(16,642)
Mortgage loans sold or securitized	(168,652)
Write-down of loans to lower of cost or market	(14,221)
Balance at December 31, 1999	\$ 118,239

The geographic distribution of the Company's single family and commercial loans held for sale or securitization at December 31, 1999 is as follows:

State	Number of Loans	Principal Amount
California	2	\$ 3,798
Colorado	2	10,766
Georgia	1	115
Kansas	1	1,233
Kentucky	1	115
Louisiana	6	47,381
Michigan	3	4,901
Minnesota	4	17,116
Mississippi	1	434
North Carolina	9	6,348
Nebraska	1	1,538
New York	2	4,753
Oregon	1	78
South Carolina	3	6,626
Tennessee	6	4,561
Texas	4	17,799
Utah	1	1,357
Virginia	4	5,505
Wisconsin	1	573
West Virginia	1	70
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Total		135,067
Write-down to lower of cost or market		(14,221)
Net premium/discount		(2,581)
Allowance for loan losses		(26)
<hr/>		
		\$ 118,239