

Crystal River Capital, Inc.
Form 10-Q
May 15, 2007

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

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

OR

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

For the transition period from to

Commission File Number 001-32958

Crystal River Capital, Inc.
(Exact name of registrant as specified in its charter)

Maryland
*(State or other jurisdiction of
incorporation or organization)*

20-2230150
*(I.R.S. Employer
Identification No.)*

**Three World Financial Center,
200 Vesey Street, 10th Floor, New York, NY**
(Address of principal executive offices)

10281-1010
(Zip Code)

Registrant's telephone number, including area code: **(212) 549-8400**

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of outstanding shares of the registrant's common stock, par value \$0.001 per share, as of May 14, 2007 was 25,001,800.

CRYSTAL RIVER CAPITAL, INC.

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PART I.
FINANCIAL INFORMATION

Item 1. Financial Statements

Crystal River Capital, Inc. and Subsidiaries

Consolidated Balance Sheets
(in thousands, except share and per share data)

	March 31, 2007 (Unaudited)	December 31, 2006
ASSETS:		
Available for sale securities, at fair value		
Commercial MBS	\$ 493,306	\$ 472,572
Residential MBS Non-Agency MBS	270,705	287,243
Agency MBS	2,010,836	2,532,101
ABS	44,162	46,132
Preferred stock	4,018	4,560
Real estate loans	252,680	237,670
Commercial real estate, net	210,961	
Other investments	58,115	20,133
Intangible assets	83,381	
Cash and cash equivalents	42,586	39,023
Restricted cash	76,419	79,483
Receivables:		
Principal paydown	6,417	5,940
Interest	16,081	19,380
Interest purchased	437	875
Swap receivable	3,614	1,948
Other receivable	13,617	
Prepaid expenses and other assets	2,641	1,791
Deferred financing costs, net	11,223	4,929
Derivative assets	14,195	20,865
Total Assets	\$ 3,615,394	\$ 3,774,645
LIABILITIES AND STOCKHOLDERS EQUITY:		
Liabilities:		
Accounts payable, accrued expenses and cash collateral payable	\$ 3,115	\$ 11,486
Due to Manager	4,131	2,040
Due to broker	80,454	94,881
Dividends payable	17,032	16,514
Intangible liabilities	73,403	

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Repurchase agreements	1,989,928	2,723,643
Repurchase agreements, related party	124,806	144,806
Collateralized debt obligations	516,895	194,396
Junior subordinated notes	51,550	
Mortgage payable	198,500	
Interest payable	17,583	19,417
Derivative liabilities	17,137	11,148
Total Liabilities	3,094,534	3,218,331
Commitments and Contingencies		
Stockholders' Equity:		
Preferred Stock, par value \$0.001 per share, 100,000,000 shares authorized, no shares issued and outstanding		
Common Stock, \$0.001 par value, 500,000,000 shares authorized, 25,021,800 shares issued and outstanding		
	25	25
Additional paid-in capital	566,676	566,285
Accumulated other comprehensive income (loss)	(13,145)	13,212
Declared dividends in excess of earnings	(32,696)	(23,208)
Total Stockholders' Equity	520,860	556,314
Total Liabilities and Stockholders' Equity	\$ 3,615,394	\$ 3,774,645

See accompanying notes to consolidated financial statements.

Table of Contents**Crystal River Capital, Inc. and Subsidiaries****Consolidated Statements of Income**
(in thousands, except share and per share data)

(Unaudited)

	Three Months Ended	
	March 31,	
	2007	2006
Revenues:		
Interest and dividend income:		
Interest income available for sale securities	\$ 50,204	\$ 37,740
Interest income real estate loans	4,325	2,611
Other interest and dividend income	2,700	727
Total interest and dividend income	57,229	41,078
Rental income, net	538	
Total revenues	57,767	41,078
Expenses:		
Interest expense	40,135	28,851
Management fees, related party	2,353	1,677
Professional fees	782	761
Depreciation and amortization	311	
Incentive fees	124	
Insurance expense	82	91
Directors fees	162	144
Public company expense	71	
Other expenses	231	92
Total expenses	44,251	31,616
Other revenues (expenses):		
Realized net gain (loss) on sale of real estate loans and securities available for sale	1,620	(568)
Realized and unrealized (loss) gain on derivatives	(8,450)	7,930
Impairment of available for sale securities	(635)	(1,258)
Foreign currency exchange gain (loss)	502	(192)
Income from equity investments	849	
Other	142	70
Total other revenues (expenses)	(5,972)	5,982
Net income	\$ 7,544	\$ 15,444

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Per share information:

Net income per share of common stock

Basic	\$	0.30	\$	0.88
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Diluted	\$	0.30	\$	0.88
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Dividends declared per share of common stock	\$	0.68	\$	0.725
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Weighted average shares of common stock outstanding

Basic	25,043,565	17,495,082
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Diluted	25,043,565	17,495,082
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See accompanying notes to consolidated financial statements.

Table of Contents**Crystal River Capital, Inc. and Subsidiaries**

Consolidated Statement of Changes in Stockholders' Equity
For the Three Months Ended March 31, 2007
(in thousands, except share data)
(Unaudited)

	Common Stock	Par	Additional	Other	Declared		Comprehensive
	Shares	Value	Paid-In	Comprehensive	Dividends		Income
			Capital	Income	in	Total	(Loss)
				(Loss)	Excess of		
					Earnings		
Balance at							
December 31, 2006	25,021,800	\$ 25	\$ 566,285	\$ 13,212	\$ (23,208)	\$ 556,314	
Net income					7,544	7,544	\$ 7,544
Net unrealized							
holdings loss on							
securities available							
for sale				(21,113)		(21,113)	(21,113)
Unrealized loss on							
cash flow hedges				(2,116)		(2,116)	(2,116)
Realized net loss on							
cash flow hedges				(2,738)		(2,738)	(2,738)
Amortization of net							
realized gains on cash							
flow hedges				(390)		(390)	(390)
Comprehensive loss							\$ (18,813)
Dividends declared							
on common stock					(17,032)	(17,032)	
Offering costs			(48)			(48)	
Issuance of stock							
based compensation:							
Amortization of stock							
based compensation			439			439	
Balance at March 31,							
2007	25,021,800	\$ 25	\$ 566,676	\$ (13,145)	\$ (32,696)	\$ 520,860	

See accompanying notes to consolidated financial statements.

Table of Contents**Crystal River Capital, Inc. and Subsidiaries****Consolidated Statements of Cash Flows
(in thousands)
(Unaudited)**

	Three Months Ended March 31,	
	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 7,544	\$ 15,444
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of stock based compensation	439	343
Accretion of net discount on available for sale securities and loans	(3,161)	(1,997)
Realized net loss (gain) on sale of available for sale securities	(1,620)	568
Impairment of available for sale securities	635	1,258
Accretion of interest on real estate loans	(327)	
Amortization of net realized cash flow hedge gain	(390)	(34)
Unrealized (gain) loss on derivatives	8,585	(7,568)
Amortization of deferred financing costs	622	485
Income from equity investment	(849)	
Change in deferred income tax	750	
(Gain) loss on foreign currency translation	(502)	243
Depreciation and amortization	311	
Amortization of intangible liabilities	(138)	
Other	315	38
Changes in operating assets and liabilities:		
Payments on settlement of derivatives	(481)	
Interest receivable	2,652	(2,823)
Proceeds from settlement of derivatives	560	
Prepaid expenses and other assets	522	(487)
Return on capital from equity investments	652	
Accounts payable and accrued liabilities	(6,825)	(1,901)
Due to Manager	2,091	1,447
Interest payable	(1,834)	3,059
Interest payable, derivative	(1,675)	404
Net cash provided by operating activities	7,876	8,479
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of securities available for sale	(148,670)	(595,484)
Acquisition of interest in other investments	(35,004)	
Acquisition of commercial real estate	(234,710)	
Interest purchased	(136)	(145)
Underwriting costs on available for sale securities and real estate loans	(78)	(316)

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Principal payments on available for sale securities and real estate loans	124,655	111,701
Proceeds from the sale of available for sale securities	512,161	182,482
Proceeds from the repayment of real estate loans		15,845
Net deposits of restricted cash for investment	(16,498)	
Funding of real estate loans	(14,864)	(6,914)
Net cash provided by (used in) investing activities	186,856	(292,831)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from junior subordinated notes held by trust that issued trust preferred securities	50,000	
Due from affiliate		(1,050)
Payment on settlement of derivatives	(5,495)	
Proceeds from the settlement of derivatives	1,388	
Net change in cash collateral payable	(430)	
Issuance of collateralized debt obligations	324,956	
Proceeds from mortgage payable	198,500	
Principal repayments on collateralized debt obligations	(2,457)	(16,290)
Net (deposits into) return of restricted cash	19,562	(52,783)
Payment of deferred financing costs	(6,916)	(210)
Dividends paid	(16,514)	
Repayment of note payable, related party		(35,000)
Net (payments on) proceeds from repurchase agreements	(733,715)	349,323
Net (payments on) proceeds from repurchase agreements, related party	(20,000)	40,805
Offering costs	(48)	
Net cash (used in) provided by financing activities	(191,169)	284,795
Net increase in cash and cash equivalents	3,563	443
Cash and cash equivalents at beginning of period	39,023	21,463
Cash and cash equivalents at end of period	\$ 42,586	\$ 21,906
Supplemental disclosure of cash flows:		
Cash paid during the period for interest	\$ 43,014	\$ 24,545
Supplemental disclosure of noncash investing and financing activities:		
Receivable on credit default swaps	3,614	
Dividends declared, not yet paid	17,032	12,707
Principal paydown receivable	6,417	9,394
Purchase of available for sale securities not yet settled	80,153	5,500
Equity investment in trust	1,550	
Capitalization of interest on other investments	1,164	

See accompanying notes to consolidated financial statements.

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Crystal River Capital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

March 31, 2007

(in thousands, except share and per share data)

(unaudited)

1. ORGANIZATION

References herein to we, us or our refer to Crystal River Capital, Inc. and its subsidiaries unless the context specifically requires otherwise.

We are a Maryland corporation that was formed in January 2005 for the purpose of acquiring and originating a diversified portfolio of commercial and residential real estate structured finance investments. We commenced operations on March 15, 2005, when we completed an offering of 17,400,000 shares of common stock (the Private Offering), and we completed our initial public offering of 7,500,000 shares of common stock (the Public Offering) on August 2, 2006, as more fully explained in Note 13. We are externally managed and are advised by Hyperion Brookfield Crystal River Capital Advisors, LLC (the Manager) as more fully explained in Note 11.

We have elected to be taxed as a Real Estate Investment Trust (REIT) under the Internal Revenue Code for the 2005 tax year. To maintain our tax status as a REIT, we plan to distribute at least 90% of our taxable income. In view of our election to be taxed as a REIT, we have tailored our balance sheet investment program to originate or acquire loans and investments to produce a portfolio that meets the asset and income tests necessary to maintain qualification as a REIT.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Quarterly Presentation The accompanying unaudited consolidated financial statements have been prepared in conformity with the instructions to Form 10-Q and Article 10, Rule 10-01 of Regulation S-X for interim financial statements. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States (GAAP) for complete financial statements. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and changes in cash flows have been made. These consolidated financial statements should be read in conjunction with the annual financial statements and notes thereto for the year ended December 31, 2006 included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission (the SEC).

Principles of Consolidation Our consolidated financial statements include the accounts of Crystal River Capital, Inc., three wholly-owned subsidiaries created in connection with our collateralized debt obligations, three wholly-owned subsidiaries established for financing purposes, three wholly-owned subsidiaries established to own interests in real property and our taxable REIT subsidiary (TRS). All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates The preparation of financial statements in conformity with GAAP requires us to make a significant number of estimates in the preparation of the financial statements. These estimates include determining the fair market value of certain investments and derivative liabilities, amount and timing of credit losses, prepayment assumptions, allocation of purchase price to tangible and intangible assets on property acquisitions, and other items that affect the reported amounts of certain assets and liabilities as of the date of the consolidated financial statements and the reported amounts of certain revenues and expenses

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Crystal River Capital, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
March 31, 2007**

**(in thousands, except share and per share data)
(unaudited)**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

during the reported period. It is likely that changes in these estimates (*e.g.*, market values change due to changes in supply and demand, credit performance, prepayments, interest rates, or other reasons; yields change due to changes in credit outlook and loan prepayments) will occur in the near future. Our estimates are inherently subjective in nature and actual results could differ from our estimates and differences may be material.

Cash and Cash Equivalents We classify highly liquid investments with original maturities of 90 days or less from the date of purchase as cash equivalents. Cash and cash equivalents may include cash and short term investments. Short term investments are stated at cost, which approximates their fair value, and may consist of investments in money market accounts.

Restricted Cash Restricted cash consists primarily of funds held on deposit with brokers to serve as collateral for repurchase agreements, certain interest rate swap agreements and funds held by the trustee for CDO II (see Note 6) to fund future purchases of available for sale securities.

Securities We invest in U.S. Agency residential mortgage-backed securities (Agency ARMS), Non-Agency residential mortgage-backed securities (Non-Agency RMBS), commercial mortgage-backed securities (CMBS) and other real estate debt and equity instruments. We account for our available for sale securities (Agency ARMS, CMBS, RMBS, asset-backed securities (ABS) and other real estate and equity instruments) in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115). We classify our securities as available for sale because we may dispose of them prior to maturity in response to changes in the market, liquidity needs or other events, even though we do not hold the securities for the purpose of selling them in the near future.

All investments classified as available for sale are reported at fair value, based on quoted market prices provided by independent pricing sources, when available, or from quotes provided by dealers who make markets in certain securities, or from our management's estimates in cases where the investments are illiquid. In making these estimates, our management utilizes pricing information obtained from dealers who make markets in these securities. However, under certain circumstances we may adjust these values based on our knowledge of the securities and the underlying collateral. Our management also uses a discounted cash flow model, which utilizes prepayment and loss assumptions based upon historical experience, economic factors and the characteristics of the underlying cash flow in order to substantiate the fair value of the securities. The assumed discount rate is based upon the yield of comparable securities. The determination of future cash flows and the appropriate discount rates are inherently subjective and, as a result, actual results may vary from our management's estimates.

Unrealized gains and losses are recorded as a component of accumulated other comprehensive income (loss) in stockholders' equity.

Periodically, all available for sale securities are evaluated for other than temporary impairment in accordance with SFAS 115 and Emerging Issues Task Force (EITF) No. 99-20, *Recognition of Interest Income and Impairment on*

Purchased and Retained Beneficial Interests in Securitized Financial Assets (EITF 99-20). An impairment that is an other than temporary

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Crystal River Capital, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
March 31, 2007**

**(in thousands, except share and per share data)
(unaudited)**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

impairment is a decline in the fair value of an investment below its amortized cost attributable to factors that indicate the decline will not be recovered over the remaining life of the investment. Other than temporary impairments result in reducing the carrying value of the security to its fair value through the statement of income, which also creates a new carrying value for the investment. We compute a revised yield based on the future estimated cash flows as described in the section titled *Revenue Recognition* below. Significant judgments, including making assumptions regarding the estimated prepayments, loss assumptions and the changes in interest rates, are required in determining impairment.

Real Estate Loans Real estate loans are carried at cost, net of unamortized loan origination costs and fees, discounts, repayments, sales of partial interests in loans and unfunded commitments, unless the loan is deemed to be impaired. We account for our real estate loans in accordance with SFAS No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (SFAS 91).

Real estate loans are evaluated for possible impairment on a periodic basis in accordance with SFAS No. 114, *Accounting by Creditors For Impairment of a Loan an Amendment of FASB Statement No. 5 and 15* (SFAS 114). Impairment occurs when we determine it is probable that we will not be able to collect all amounts due according to the contractual terms of the loan. Upon determination of impairment, we establish a reserve for loan losses and recognize a corresponding charge to the statement of income through a provision for loan losses. Significant judgments are required in determining impairment, including making assumptions regarding the value of the loan and the value of the real estate, partnership interest or other collateral that secures the loan.

Commercial Real Estate Commercial properties held for investment are carried at cost less accumulated depreciation. In accordance with SFAS No. 141, *Business Combinations*, upon acquisition, we allocate the purchase price to the components of the commercial properties acquired: the amount allocated to land is based on its estimated fair value; buildings and existing tenant improvements are recorded at depreciated replacement cost; above- and below-market in-place operating leases are determined based on the present value of the difference between the rents payable under the contractual terms of the leases and estimated market rents; lease origination costs for in-place operating leases are determined based on the estimated costs that would be incurred to put the existing leases in place under the same terms and conditions; and tenant relationships are measured based on the present value of the estimated avoided net costs if a tenant were to renew its lease at expiry, discounted by the probability of such renewal.

Depreciation on buildings is provided on a straight-line basis over the useful lives of the properties to a maximum of 40 years. Depreciation is determined with reference to each rental property's carried value, remaining estimated useful life and residual value. Acquired tenant improvements, above- and below-market in-place operating leases and lease origination costs are amortized on a straight-line basis over the remaining terms of the leases. The value associated with acquired tenant relationships is amortized on a straight-line basis over the expected term of the relationships. All other tenant improvements and re-leasing costs are deferred and amortized on a straight-line basis over the terms of the leases to which they relate. Depreciation on buildings and amortization of deferred leasing costs and tenant

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Crystal River Capital, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
March 31, 2007**

**(in thousands, except share and per share data)
(unaudited)**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

improvements that are determined to be assets of the company are recorded in depreciation and amortization expense. All above-and below-market tenant leases and tenant relationships are amortized to revenue. Above- and below-market ground leases are amortized to operating expenses.

Properties are reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. For commercial properties, an impairment loss is recognized when a property's carrying value exceeds its undiscounted future net cash flow. The impairment is measured as the amount by which the carrying value exceeds the estimated fair value. Projections of future cash flow take into account the specific business plan for each property and management's best estimate of the most probable set of economic conditions anticipated to prevail in the market.

Accounting for Derivative Financial Instruments and Hedging Activities We account for our derivative and hedging activities in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) and SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (SFAS 149). SFAS 133 and SFAS 149 require us to recognize all derivative instruments at their fair value as either assets or liabilities on our balance sheet. The accounting for changes in fair value (*i.e.*, gains or losses) of a derivative instrument depends on whether we have designated it, and whether it qualifies, as part of a hedging relationship and on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, we must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, a cash flow hedge or a hedge of a net investment in a foreign operation. We have no fair value hedges or hedges of a net investment in foreign operations as of March 31, 2007.

For derivative instruments that are designated and qualify as a cash flow hedge (*i.e.*, hedging the exposure to variability in expected future cash flows that are attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings (*i.e.*, in interest expense when the hedged transactions are interest cash flows associated with floating-rate debt). The remaining gain or loss on the derivative instrument in excess of the cumulative changes in the present value of future cash flows of the hedged item, if any, is recognized in the realized and unrealized gain (loss) on derivatives in current earnings during the period of change. For derivative instruments not designated as hedging instruments (including foreign currency swaps and credit default swaps), the gain or loss is recognized in realized and unrealized gain (loss) on derivatives in the current earnings during the period of change. Income and/or expense from interest rate swaps are recognized as an adjustment to interest expense. We account for income and expense from interest rate swaps on an accrual basis over the period to which the payments and/or receipts relate.

Dividends to Stockholders We record dividends to stockholders on the declaration date. The actual dividend and its timing are at the discretion of our board of directors. We intend to pay sufficient dividends to avoid incurring any income or excise tax. During the three months ended March 31, 2007, we declared dividends in the amount of

\$0.68 per share of which

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Crystal River Capital, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
March 31, 2007**

**(in thousands, except share and per share data)
(unaudited)**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

\$17,032 was distributed on April 27, 2007 to our stockholders of record as of March 30, 2007, and of which \$17 related to dividends on deferred stock units.

Offering Costs Offering costs that were incurred in connection with the Private Offering and the Public Offering are reflected as a reduction of additional paid-in-capital. Certain offering costs that were incurred in connection with the Public Offering were initially capitalized to prepaid expenses and other assets and were recorded as a reduction of additional paid-in-capital when we completed the Public Offering in August 2006.

Trust Preferred Securities Trusts that we form for the sole purpose of issuing trust preferred securities are not consolidated in our financial statements in accordance with Financial Interpretation No. 46R (FIN 46R) as we have determined that we are not the primary beneficiary of such trusts. Our investment in the common securities of such trusts is included in other assets in our consolidated financial statements.

Revenue Recognition Interest income for our available for sale securities and real estate loans is recognized over the life of the investment using the effective interest method and recorded on the accrual basis. Interest income on mortgage-backed securities (MBS) is recognized using the effective interest method as required by EITF 99-20. Real estate loans generally are originated or purchased at or near par value, and interest income is recognized based on the contractual terms of the loan instruments. Any loan fees or acquisition costs on originated loans or securities are capitalized and recognized as a component of interest income over the life of the investment utilizing the straight-line method, which approximates the effective interest method. None of the interest income for the three months ended March 31, 2007 or 2006 included prepayment fees.

Under EITF 99-20, at the time of purchase, our management estimates the future expected cash flows and determines the effective interest rate based on these estimated cash flows and the purchase price. As needed, we update these estimated cash flows and compute a revised yield based on the current amortized cost of the investment. In estimating these cash flows, there are a number of assumptions that are subject to uncertainties and contingencies, including the rate and timing of principal payments (including prepayments, repurchases, defaults and liquidations), the pass-through or coupon rate and interest rate fluctuations. In addition, interest payment shortfalls due to delinquencies on the underlying mortgage loans and the timing and the magnitude of credit losses on the mortgage loans underlying the securities have to be judgmentally estimated. These uncertainties and contingencies are difficult to predict and are subject to future events that may impact our management's estimates and our interest income.

We record security transactions on the trade date. Realized gains and losses from security transactions are determined based upon the specific identification method and recorded as gain (loss) on sale of available for sale securities in the statements of income.

We account for accretion of discounts or premiums on available for sale securities and real estate loans using the effective interest yield method. Such amounts have been included as a component of interest income in the statements of income.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

We may sell all or a portion of our real estate investments to a third party. To the extent the fair value received for an investment differs from the amortized cost of that investment and control of the asset that is sold is surrendered making it a true sale, as defined under SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* a replacement of FASB Statement No. 125 (SFAS 140), a gain or loss on the sale will be recorded in the statements of income as realized net gain (loss) on sale of real estate loans. To the extent a real estate investment is sold that has any fees that were capitalized at the time the investment was made and were being recognized over the term of the investment, the unamortized fees are recognized at the time of sale and included in any gain or loss on sale of real estate loans.

We have retained substantially all of the risks and benefits of ownership of our rental properties and therefore we account for leases with our tenants as operating leases. The total amount of contractual rent that we receive from operating leases is recognized on a straight-line basis over the term of the lease; and a straight-line or free rent receivable, as applicable, is recorded for the difference between the rental revenue recorded and the contractual amount received. In addition to base rent, the tenants in our commercial real estate properties also pay substantially all operating costs.

Dividend income on preferred stock is recorded on the dividend declaration date.

Interest in Equity Investment We account for our investment in BREF One, LLC, a real estate finance fund, under the equity method of accounting since we own more than a minor interest in the fund, but do not unilaterally control the fund and are not considered to be the primary beneficiary under FIN 46R. The investment was recorded initially at cost, and subsequently adjusted for equity in net income (loss) and cash contributions and distributions.

Income Taxes We have elected to be taxed as a REIT under the Internal Revenue Code and the corresponding provisions of state law. In order to qualify as a REIT, we must distribute at least 90% of our annual REIT taxable income to stockholders within the statutory timeframe. Accordingly, we generally will not be subject to federal or state income tax to the extent that we make qualifying distributions to our stockholders and provided we satisfy the REIT requirements, including certain asset, income, distribution and stock ownership tests. If we were to fail to meet these requirements, we would be subject to federal, state and local income taxes, which could have a material adverse impact on our results of operations and amounts available for distribution to our stockholders.

The dividends paid deduction of a REIT for qualifying dividends to our stockholders is computed using our taxable income as opposed to using our financial statement net income. Some of the significant differences between financial statement net income and taxable income include the timing of recording unrealized gains/realized gains associated with certain assets, the book/tax basis of assets, interest income, impairment, credit loss recognition related to certain assets (asset-backed mortgages), accounting for derivative instruments and stock compensation and amortization of various costs (including start up costs).

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

SFAS No. 109, *Accounting for Income Taxes* (SFAS 109), establishes financial accounting and reporting standards for the effect of income taxes that result from an organization's activities during the current and preceding years. SFAS 109 requires that income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for book and tax purposes. A deferred tax asset or liability for each temporary difference is determined based upon the tax rates that the organization expects to be in effect when the underlying items of income and expense are realized. A deferred tax valuation allowance is established if it is more likely than not that all or a portion of the deferred tax assets will not be realized.

We have a wholly-owned taxable REIT subsidiary that has made a joint election with us to be treated as our TRS. Our TRS is a separate entity subject to federal income tax under the Internal Revenue Code. For the three months ended March 31, 2007 and 2006, we recorded current income tax expense of \$339 (federal income tax of \$215 and state and local income tax of \$124) and \$0, respectively, which is included in other expenses. For the three months ended March 31, 2007 and 2006, we recorded a deferred tax benefit of \$750 and \$0, respectively, which is included in other expenses. As of March 31, 2007, we had a deferred tax liability of \$150 attributable to mark to market adjustments on foreign currency swaps held in our TRS which is included in accounts payable, accrued expenses and cash collateral payable. As of December 31, 2006 we had a deferred tax liability of \$900 attributable to mark to market adjustments on foreign currency swaps held in our TRS of \$900 which is included in accounts payable, accrued expenses and cash collateral payable.

In June 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, or FIN 48. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation was effective January 1, 2007. The adoption of FIN 48 did not materially affect our consolidated financial statements.

Our policy for interest and penalties on material uncertain tax positions recognized in our consolidated financial statements is to classify these as interest expense and operating expense, respectively. However, in accordance with FIN 48 we assessed our tax positions for all open tax years (Federal, years 2005 to 2006 and State, years 2005 to 2006) as of March 31, 2007 and concluded that we have no material FIN 48 liabilities to be recognized at this time.

Deferred Financing Costs Deferred financing costs represent commitment fees, legal fees and other third party costs associated with obtaining commitments for financing that result in a closing of such financing. These costs are amortized over the terms of the respective agreements using the effective interest method or a method that approximates the effective interest method and the amortization is reflected in interest expense. Unamortized deferred financing costs are expensed when the associated debt is refinanced or repaid before maturity.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Costs incurred in seeking financing transactions that do not close are expensed in the period in which it is determined that the financing will not close.

Earnings per Share We compute basic and diluted earnings per share in accordance with SFAS No. 128, *Earnings Per Share* (SFAS 128). Basic earnings per share (EPS) is computed based on net income divided by the weighted average number of shares of common stock and other participating securities outstanding during the period. Diluted EPS is based on net income divided by the weighted average number of shares of common stock plus any additional shares of common stock attributable to stock options, provided that the options have a dilutive effect. At March 31, 2007 and March 31, 2006, options to purchase a total of 130,000 shares of common stock and 126,000 shares of common stock, respectively, have been excluded from the computation of diluted EPS as they were determined to be antidilutive.

Variable Interest Entities In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities An Interpretation of ARB No. 51* (FIN 46). FIN 46 provides guidance on identifying entities for which control is achieved through means other than through voting rights and on determining when and which business enterprise should consolidate a variable interest entity (VIE) when such enterprise would be determined to be the primary beneficiary. In addition, FIN 46 requires that both the primary beneficiary and all other enterprises with a significant variable interest in a VIE make additional disclosures. In December 2003, the FASB issued a revision of FIN 46, Interpretation No. 46R (FIN 46R), to clarify the provisions of FIN 46. FIN 46R states that a VIE is subject to consolidation if the investors in the entity being evaluated under FIN 46R either do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support, are unable to direct the entity's activities, or are not exposed to the entity's losses or entitled to its residual returns. VIEs within the scope of FIN 46R are required to be consolidated by their primary beneficiary. The primary beneficiary of a VIE is determined to be the party that absorbs a majority of the VIE's expected losses, receives the majority of the VIE's expected returns, or both.

Our ownership of the subordinated classes of CMBS and RMBS from a single issuer may provide us with the right to control the foreclosure/workout process on the underlying loans, which we refer to as the Controlling Class CMBS and RMBS. There are certain exceptions to the scope of FIN 46R, one of which provides that an investor that holds a variable interest in a qualifying special-purpose entity (QSPE) is not required to consolidate that entity unless the investor has the unilateral ability to cause the entity to liquidate. SFAS 140 sets forth the requirements for an entity to qualify as a QSPE. To maintain the QSPE exception, the special-purpose entity must initially meet the QSPE criteria and must continue to satisfy such criteria in subsequent periods. A special-purpose entity's QSPE status can be affected in future periods by activities undertaken by its transferor(s) or other involved parties, including the manner in which certain servicing activities are performed. To the extent that our CMBS or RMBS investments were issued by a special-purpose entity that meets the QSPE requirements, we record those investments at the purchase price paid. To the extent the underlying special-purpose entities do not satisfy the QSPE requirements, we follow the guidance set forth in FIN 46R as the special-purpose entities would be determined to be VIEs.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

We have analyzed the pooling and servicing agreements governing each of our Controlling Class CMBS and RMBS investments for which we own a greater than 50% interest in the subordinated class and we believe that the terms of those agreements are industry standard and are consistent with the QSPE criteria. However, there is uncertainty with respect to QSPE treatment for those special-purpose entities due to ongoing review by regulators and accounting standard setters (including the FASB's project to amend SFAS 140 and the recently added FASB project on servicer discretion in a QSPE), potential actions by various parties involved with the QSPE (discussed in the paragraph above) and varying and evolving interpretations of the QSPE criteria under SFAS 140. We also have evaluated each of our Controlling Class CMBS and RMBS investments as if the special-purpose entities that issued such securities are not QSPEs. Using the fair value approach to calculate expected losses or residual returns, we have concluded that we would not be the primary beneficiary of any of the underlying special-purpose entities. Additionally, the standard setters continue to review the FIN 46R provisions related to the computations used to determine the primary beneficiary of VIEs.

Our maximum exposure to loss as a result of our investment in these QSPEs totaled \$238,278 as of March 31, 2007.

The financing structures that we offer to the borrowers on certain of our real estate loans involve the creation of entities that could be deemed VIEs and therefore, could be subject to FIN 46R. Our management has evaluated these entities and has concluded that none of them are VIEs that are subject to the consolidation rules of FIN 46R.

Stock Based Compensation We account for stock-based compensation in accordance with the provisions of SFAS No. 123R, *Accounting for Stock-Based Compensation* (SFAS 123R), which establishes accounting and disclosure requirements using fair value based methods of accounting for stock-based compensation plans. Compensation expense related to grants of stock and stock options are recognized over the vesting period of such grants based on the estimated fair value on the grant date.

Stock compensation awards granted to the Manager and certain employees of the Manager's affiliates are accounted for in accordance with EITF 96-18, *Accounting For Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods and Services*, which requires us to measure the fair value of the equity instrument using the stock prices and other measurement assumptions as of the earlier of either the date at which a performance commitment by the counterparty is reached or the date at which the counterparty's performance is complete.

Concentration of Credit Risk and Other Risks and Uncertainties Our investments are primarily concentrated in MBS that pass through collections of principal and interest from the underlying mortgages and there is a risk that some borrowers on the underlying mortgages will default. Therefore, MBS may bear some exposure to credit losses. Our maximum exposure to loss due to credit risk if all parties to the investments failed completely to perform according to the terms of the contracts as of March 31, 2007 is \$2,823,027. Our real estate loans and other investments may bear some exposure to credit losses. Our maximum exposure to loss due to credit risk if parties to the real estate loans,

related and unrelated, and other investments failed completely to perform according to the terms of the loans as of March 31, 2007 is \$252,680.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

We bear certain other risks typical in investing in a portfolio of MBS. Principal risks potentially affecting our financial position, income and cash flows include the risk that (i) interest rate changes can negatively affect the market values of our MBS, (ii) interest rate changes can influence decisions made by borrowers in the mortgages underlying the securities to prepay those mortgages, which can negatively affect both the cash flows from, and the market value of, our MBS and (iii) adverse changes in the market value of our MBS and/or our inability to renew short term borrowings would result in the need to sell securities at inopportune times and cause us to realize losses.

Other financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash and cash equivalents and real estate loans. We place our cash and cash equivalents in excess of insured amounts with high quality financial institutions. The collateral securing our real estate loans and other investments are located in the United States, Canada and the United Kingdom.

Credit risk also arises from the possibility that tenants may be unable to fulfill their lease commitments. We have a significant concentration of rental revenue from both of our commercial properties given that JPMorgan Chase is the main tenant of both properties. Therefore, we are subject to concentration of credit risk, and the inability of this tenant to make its lease payments could have an adverse effect on us. Our exposure to this credit risk is mitigated since we have long-term leases in place for both properties with a tenant that has an investment grade credit rating.

Other Comprehensive Income (Loss) Comprehensive income (loss) consists of net income and other comprehensive income (loss). Our other comprehensive income (loss) is comprised primarily of unrealized gains and losses on securities available for sale and net unrealized and deferred gains and losses on certain derivative investments accounted for as cash flow hedges.

Securities Repurchase Agreements In securities repurchase agreements, we transfer securities to a counterparty under an agreement to repurchase the same securities at a fixed price in the future. These agreements are accounted for as secured financing transactions as we maintain effective control over the transferred securities and the transfer meets the other criteria for such accounting. The transferred securities are pledged by us as collateral to the counterparty.

Foreign Currency Transactions We conform to the requirements of SFAS No. 52, *Foreign Currency Translation* (SFAS 52). SFAS 52 requires us to record realized and unrealized gains and losses from transactions denominated in a currency other than our functional currency (U.S. dollar) in determining net income.

Recent Accounting Pronouncements Not Yet Adopted In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 clarifies the definition of fair value, establishes a framework for measuring fair value in GAAP and requires expanded financial statement disclosures about fair value measurements for assets and liabilities. SFAS 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy as defined in the standard. SFAS 157 is effective for fiscal periods beginning after November 15, 2007. SFAS 157 will be effective for us beginning January 1,

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(unaudited)****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

2008 and we are currently evaluating the effects of SFAS 157 on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for financial statements issued for fiscal periods beginning after November 15, 2007. SFAS 159 will be effective for us beginning January 1, 2008 and we are currently evaluating the effects of SFAS 159 on our consolidated financial statements.

Presentation Certain reclassifications have been made in the presentation of the prior periods consolidated financial statements to conform to the March 2007 presentation.

3. AVAILABLE FOR SALE SECURITIES

Our available for sale securities are carried at their estimated fair values. The amortized cost and estimated fair values of our available for sale securities as of March 31, 2007 are summarized as follows:

Security Description	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
CMBS	\$ 497,819	\$ 5,717	\$ (10,230)	\$ 493,306
Residential MBS-Non-Agency ARMs	279,739	6,928	(15,962)	270,705
Residential MBS-Agency ARMs	2,016,019	2,730	(7,913)	2,010,836
ABS	42,151	2,011		44,162
Preferred stock	4,852		(834)	4,018
Total	\$ 2,840,580	\$ 17,386	\$ (34,939)	\$ 2,823,027

We pledge our available for sale securities to secure our repurchase agreements and collateralized debt obligations. The fair value of the available for sale securities that we pledged as collateral as of March 31, 2007 is summarized as follows:

Pledged as Collateral:	March 31, 2007
For borrowings under repurchase agreements	\$ 2,033,419
For borrowings under collateralized debt obligations	557,147
Total	\$ 2,590,566

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(unaudited)****3. AVAILABLE FOR SALE SECURITIES (Continued)**

The aggregate estimated fair values by underlying credit rating of our available for sale securities as of March 31, 2007 was as follows:

Security Rating	March 31, 2007	
	Estimated Fair Value	Percentage
AAA	\$ 2,010,836	71.23%
AA		
A	36,818	1.30
BBB	337,513	11.96
BB	220,478	7.81
B	130,348	4.62
Not rated	87,034	3.08
Total	\$ 2,823,027	100.00%

The face amount and net unearned discount on our investments as of March 31, 2007 was as follows:

Description:	March 31, 2007
Face amount	\$ 3,132,040
Net unearned discount	(291,460)
Amortized cost	\$ 2,840,580

For the three months ended March 31, 2007 and the three months ended March 31, 2006, net discount on available for sale securities accreted into interest income totaled \$3,201 and \$1,997, respectively.

Commercial Mortgage Backed Securities (CMBS) Our investments include CMBS, which are mortgage backed securities that are secured by, or evidence ownership interests in, a single commercial mortgage loan, or a partial or entire pool of mortgage loans secured by commercial properties. The securities may be senior, subordinated, investment grade or non-investment grade.

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(unaudited)****3. AVAILABLE FOR SALE SECURITIES (Continued)**

The following is a summary of our CMBS investments as of March 31, 2007:

Security Rating	Amortized	Gross Unrealized		Estimated	Weighted Average		Term (yrs)
	Cost	Gains	Losses	Fair Value	Coupon	Yield	
AAA	\$	\$	\$	\$	%	%	
AA							
A							
BBB	254,124	1,846	(5,204)	250,766	5.72	6.37	9.55
BB	124,246	171	(2,608)	121,809	4.96	7.90	9.65
B	65,593	1,883	(1,867)	65,609	4.94	11.61	10.89
Not rated	53,856	1,817	(551)	55,122	5.00	16.53	11.77
Total CMBS	\$ 497,819	\$ 5,717	\$ (10,230)	\$ 493,306	5.25	8.54	10.33

Residential Mortgage Backed Securities (RMBS) Our investments include RMBS, which are securities that represent participations in, and are secured by or payable from, mortgage loans secured by residential property. Our RMBS investments include (i) Agency mortgage pass-through certificates, which are securities issued or guaranteed by the Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac) or Government National Mortgage Association (Ginnie Mae), (ii) Agency Collateralized Mortgage Obligations issued by Fannie Mae or Freddie Mac backed by mortgage pass-through securities and evidenced by a series of bonds or certificates issued in multiple classes (collectively, Agency Adjustable Rate RMBS or Agency ARMS) and (iii) Non-Agency pass-through certificates which are rated classes in senior/ subordinated structures (Non-Agency RMBS).

The following is a summary of our Non-Agency RMBS investments as of March 31, 2007:

Security Rating	Amortized	Gross Unrealized		Estimated	Weighted Average		Term (yrs)
	Cost	Gains	Losses	Fair Value	Coupon	Yield	
AAA	\$	\$	\$	\$	%	%	
AA							
A	28,857	40	(1,609)	27,288	6.71	7.84	3.04

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BBB	57,256		(5,141)	52,115	6.96	9.62	
BB	103,739	563	(7,601)	96,701	7.19	17.43	2.73
B	61,747	3,907	(915)	64,739	8.00	20.64	4.60
Not rated	28,140	2,418	(696)	29,862	6.87	37.89	2.99
Total Non-Agency RMBS	\$ 279,739	\$ 6,928	\$ (15,962)	\$ 270,705	7.23	17.61	3.26

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(unaudited)****3. AVAILABLE FOR SALE SECURITIES (Continued)**

The following is a summary of our Agency ARMS investments as of March 31, 2007:

Security Rating	Amortized	Gross Unrealized		Estimated	Weighted Average		Term (yrs)
	Cost	Gains	Losses	Fair Value	Coupon	Yield	
AAA	\$ 2,016,019	\$ 2,730	\$ (7,913)	\$ 2,010,836	5.32%	5.06%	1.91
AA							
A							
BBB							
BB							
B							
Not rated							
Total Agency ARMS	\$ 2,016,019	\$ 2,730	\$ (7,913)	\$ 2,010,836	5.32	5.06	1.91

Asset-Backed Securities (ABS) As of March 31, 2007, we invested in asset-backed securities with an estimated fair value of \$44,162. Aircraft ABS generally are collateralized by aircraft leases. Issuers of consumer and aircraft ABS generally are special-purpose entities owned or sponsored by banks and finance companies, captive finance subsidiaries of non-financial corporations or specialized originators such as credit card lenders.

The following is a summary of our ABS investments as of March 31, 2007:

Security Rating	Amortized	Gross Unrealized		Estimated	Weighted Average		Term (yrs)
	Cost	Gains	Losses	Fair Value	Coupon	Yield	
AAA	\$	\$	\$	\$	%	%	
AA							
A	9,235	295		9,530	5.70	8.19	11.96
BBB	32,916	1,716		34,632	5.80	9.17	17.75
BB							
B							
Not rated							

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Total ABS	\$ 42,151	\$ 2,011	\$	\$ 44,162	5.78	8.96	16.55
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Other Securities We invested in the preferred stock of Millerton I CDO with an estimated fair value of \$1,968 as of March 31, 2007, and the preferred stock of Millerton II CDO with an estimated fair value of \$2,050 as of March 31, 2007. The preferred stock of Millerton I CDO was rated Ba3 and the preferred stock of Millerton II CDO was not rated at March 31, 2007.

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(unaudited)****3. AVAILABLE FOR SALE SECURITIES (Continued)**

Unrealized Losses The following table sets forth the amortized cost, fair value and unrealized loss for securities we owned as of March 31, 2007:

Security Rating	Number of Securities	Amortized Cost	Fair Value	Unrealized Loss
AAA	62	\$ 1,113,721	\$ 1,105,808	\$ (7,913)
AA				
A	8	26,357	24,748	(1,609)
BBB	44	198,076	187,732	(10,344)
BB	52	193,613	183,020	(10,593)
B	37	57,974	55,192	(2,782)
Not rated	23	19,473	17,775	(1,698)
Total	226	\$ 1,609,214	\$ 1,574,275	\$ (34,939)

The unrealized losses on all securities were the result of changes in market interest rates subsequent to their purchase. The unrealized losses on non-rated bonds were also due to market conditions and price volatility. Because we have the ability and intent to hold these investments until a recovery of fair value, which may be maturity, we do not consider these investments to be other than temporarily impaired at March 31, 2007.

Other Than Temporary Impairments For the three months ended March 31, 2007, we determined that four RMBS securities were impaired. In connection with the impairment of these securities, we recorded impairment charges of \$635 in our statement of income for the three months ended March 31, 2007 that has been reclassified out of other comprehensive income. As of March 31, 2006, we held four Agency ARMS securities that we determined to be impaired. As a result, we recorded an impairment charge of \$1,258 in our statement of income for the three months ended March 31, 2006 that was reclassified out of other comprehensive income.

Sale of Available for Sale Securities During the three months ended March 31, 2007, we sold 11 securities for proceeds of \$393,501 and realized a gain of \$1,682 and we sold 4 securities for proceeds of \$118,660 and realized a loss of \$62. During the three months ended March 31, 2006, we sold one security for proceeds of \$3,263 and realized a gain of \$327, we sold five securities for proceeds of \$179,219 and realized a loss of \$895.

4. REAL ESTATE LOANS

We invest in mezzanine loans, B Notes, construction loans and whole loans. A mezzanine loan is a loan that is subordinated to a first mortgage loan on a property and is senior to the borrower's equity in the properties. Mezzanine loans are made to the property's owner and are secured by pledges of ownership interests in the property and/or the property owner. The mezzanine lender can foreclose on the pledged interests and thereby succeed to ownership of the property subject to the lien of the first mortgage.

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(unaudited)****4. REAL ESTATE LOANS (Continued)**

A subordinated commercial real estate loan, which we refer to as a B Note, may be rated by at least one nationally recognized rating agency. A B Note is typically a privately negotiated loan that is secured by a first mortgage on a single large commercial property or group of related properties; and is subordinated to an A Note secured by the same first mortgage on the same property.

A construction loan represents a participation in a construction or rehabilitation loan on a commercial property that generally provides 85% to 90% of total project costs and is secured by a first lien mortgage on the property. Alternatively, mezzanine loans can be used to finance construction or rehabilitation where the security is subordinate to the first mortgage lien. Construction loans and mezzanine loans used to finance construction or rehabilitation generally would provide fees and interest income at risk-adjusted rates.

A whole mortgage loan is a loan secured by a first lien mortgage that provides mortgage financing to commercial and residential property owners and developers. Generally, mortgage loans have maturities that range from three to 10 years for commercial properties and up to 30 years for residential properties.

The following is a summary of our real estate loans as of March 31, 2007 and December 31, 2006:

Loan Type	Number of Loans	Face Value	Carrying Value	Weighted Average Interest Rate	Maturity Range	Weighted Average Years to Maturity
March 31, 2007						
Whole loans	16	\$ 198,942	\$ 200,401	6.05%	11/2009-7/2021	8.6
Construction loans	2	20,378	20,382	11.47	11/2007-7/2008	1.0
Mezzanine loans	3	31,923	31,897	9.84	7/2008-8/2016	7.8
	21	\$ 251,243	\$ 252,680	6.96	11/2007-7/2021	7.9
December 31, 2006						
Whole loans	16	\$ 198,942	\$ 200,605	6.06%	11/2009-7/2021	8.9
Construction loans	2	20,052	20,056	11.48	11/2007-7/2008	1.3
Mezzanine loans	2	16,923	17,009	9.75	7/2008-2/2016	6.6
	20	\$ 235,917	\$ 237,670	6.78	11/2007-7/2021	8.1

The carrying values of our loans as of March 31, 2007 and December 31, 2006 include unamortized underwriting fees of \$202 and \$180, respectively.

The maturities of our real estate loans as of March 31, 2007 are as follows: \$12,440 in 2007, \$22,245 in 2008, \$8,037 in 2009, \$41,893 in 2010, \$5,276 in 2011 and \$161,352 thereafter.

In 2005, we originated a \$9,450 mezzanine construction loan to develop luxury residential condominiums in Portland, Oregon. The loan provides for an aggregate of \$6,695 of advances for construction costs and \$2,755 for capitalized interest on the outstanding loan balance. The loan bears interest at an annual rate of 16% and has a maturity date of November 2007, which

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(unaudited)****4. REAL ESTATE LOANS (Continued)**

can be extended at the borrower's option, subject to satisfying certain conditions, until May 2008. Under the agreement governing the terms of the loan, interest on the loan was paid in cash through March 2006, and was capitalized thereafter. As of March 31, 2007, we have made advances of \$8,385, including capitalized interest of \$1,489.

Currently, the projected total costs to complete the project have increased from \$41,400 to \$58,600, including capitalized interest. Of the 70 units available, 50 units have been sold subject to scheduled completion dates, which are not expected to be met. We have commenced negotiations with the senior lender and the developer regarding the developer's need to obtain additional financing to cover these additional construction costs.

We have evaluated the financial merits of the project by reviewing the projected unit sales, estimating construction costs and evaluating other collateral available to us under the terms of the loan. Our management believes that it is probable that the entire loan balance, including the capitalized interest, will be recovered through the satisfaction of future cash flows from sales and other available collateral. Accordingly, we have not recorded any impairment related to this loan. We will continue to monitor the status of this loan. However, housing prices, in particular condominium prices, may fall, unit sales may lag projections and construction costs may increase, all of which may increase the risk of impairment to our loan. No assurance can be given that this loan will not be impaired in the future depending on the outcome of the future negotiations with the senior lender and the borrower and the borrower's ability to complete the project without additional cost overruns. In the event that we determine that it is probable that we will not be able to recover the total contractual amount of principal and interest due on this loan, the loan would be impaired.

We pledge our real estate loans to secure our repurchase agreements and collateralized debt obligations. The fair value of the real estate loans that we pledged as collateral as of March 31, 2007 is summarized as follows:

	March 31, 2007
Pledged as Collateral:	
For borrowings under repurchase agreements	\$ 159,889
For borrowings under collateralized debt obligations	18,000
Total	\$ 177,889

As of March 31, 2007, our real estate loans included non-U.S. dollar denominated assets with a carrying value of \$43,328.

5. COMMERCIAL REAL ESTATE

On March 20, 2007, we acquired two properties located in Houston, Texas and Phoenix, Arizona totaling approximately 428,600 and 724,000 square feet, respectively, for an aggregate purchase price of \$234,710. Both properties are leased on a triple net basis to one tenant under leases that expire in 2021. In addition to the sale and purchase agreement, we entered into rent enhancement agreements with the seller under which we will receive payments through 2015 totaling \$15,905. The present value of such payments is recorded as other receivables totaling

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(unaudited)****5. COMMERCIAL REAL ESTATE (Continued)**

\$13,617 on our balance sheet as of March 31, 2007, which partially offsets the below-market lease terms.

The purchase price has been preliminarily allocated based on estimated fair values of the assets acquired and liabilities assumed at the date of acquisition, pending the completion of an independent appraisal relating to certain of the lease origination costs included in intangible assets, which we anticipate to be completed in the second quarter of 2007. Accordingly, the fair value of assets acquired and liabilities assumed could differ from the amounts presented currently in our consolidated financial statements. We do not expect the final allocation to be materially different from that presented below.

The following is a summary of the amounts preliminarily assigned to each major class of asset and liability at the date of acquisition:

Commercial real estate	\$ 211,119
Intangible assets	83,535
Intangible liabilities	(73,541)
Rent enhancement receivable	13,597
Total	\$ 234,710

The transaction was financed with a \$198,500 mortgage loan that bears interest at an annual rate of 5.509% (hedged rate 5.65%) and matures on April 1, 2017. We incurred financing costs of \$186, which have been deferred and are being amortized over the term of the loan.

The following is a schedule of future minimum rent payments to be received under the leases at the two properties acquired:

	Rent Payments
2007	\$ 7,311
2008	9,943
2009	10,142
2010	10,344
2011	10,551
Thereafter	114,629

The components of intangible assets and their respective weighted average lives are as follows:

	Cost	Weighted Average Life (Years)
Lease origination costs	\$ 80,819	14.6
Below-market ground lease	2,716	59.0
Total	\$ 83,535	

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(unaudited)****5. COMMERCIAL REAL ESTATE (Continued)**

As of March 31, 2007, the components of intangible assets are as follows:

	March 31, 2007
Lease origination costs	\$ 80,666
Below-market ground lease	2,715
Total	\$ 83,381

The estimated amortization of these intangible assets for the next five years is \$4,207 for the remainder of 2007, \$5,609 in 2008, \$5,609 in 2009, \$5,609 in 2010 and \$5,609 in 2011.

Below market leases, net of amortization, which are classified as intangible liabilities, are \$73,403 as of March 31, 2007. The estimated amortization for the next five years is \$3,797 for the remainder of 2007, \$5,062 in 2008, \$5,062 in 2009, \$5,062 in 2010 and \$5,062 in 2011.

6. DEBT AND OTHER FINANCING ARRANGEMENTS

The following is a summary of our debt as of March 31, 2007:

Type of Debt:

Repurchase agreements	\$ 1,989,928
Repurchase agreements, related party	124,806
Collateralized debt obligations	516,895
Mortgage payable	198,500
Junior subordinated notes held by trust that issued trust preferred securities	51,550
Total Debt	\$ 2,881,679

Repurchase Agreements As of March 31, 2007, we had entered into master repurchase agreements with various counterparties to finance our asset purchases on a short term basis. Under these agreements, we sell our assets to the counterparties and agree to repurchase those assets on a date certain at a repurchase price generally equal to the original sales price plus accrued interest. The counterparties will purchase each asset financed under the facility at a

percentage of the asset's value on the date of origination, which is the purchase rate, and we will pay interest to the counterparty at short term interest rates (usually based on one-month LIBOR) plus a pricing spread. We have agreed to a schedule of purchase rates and pricing spreads with these counterparties that generally are based upon the class and credit rating of the asset being financed. The facilities are recourse to us. For financial reporting purposes, we characterize all of the borrowings under these facilities as balance sheet financing transactions.

Under the repurchase agreements, we are required to maintain adequate collateral with these counterparties. If the market value of the collateral we have pledged declines, then the counterparty may require us to provide additional collateral to secure our obligations under the repurchase agreement. As of March 31, 2007, we were required to provide additional collateral in the amount of \$47,543, which is included in restricted cash on the balance sheet.

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As of March 31, 2007, we had repurchase agreements outstanding in the amount of \$2,114,734 with a weighted average borrowing rate of 5.50%. As of March 31, 2007, the repurchase agreements had remaining weighted average maturities of 37 days and are summarized below:

Repurchase Counterparty	Outstanding Balance	Fair Value of Collateral	Weighted Average Borrowing Rate	Maturity Range (days)
<i>Related Party</i>				
Trilon International, Inc.	\$ 124,806	\$ 159,889	5.93%	13-30
<i>Unrelated Parties</i>				
Banc of America Securities LLC	210,891	210,237	5.54%	5-46
Bear, Stearns & Co. Inc.	130,426	130,731	5.48%	5-46
Citigroup Global Markets Inc.	266,196	273,776	5.37%	39-75
Credit Suisse First Boston LLC	206,577	208,165	5.50%	5-75
Deutsche Bank Securities Inc.	345,970	350,054	5.44%	24-53
Greenwich Capital Markets, Inc.	233,310	240,849	5.37%	12-75
Goldman Sachs	7,125	9,310	5.72%	16
Lehman Brothers Inc.	140,864	150,850	5.74%	12-75
Merrill Lynch, Pierce, Fenner & Smith Incorporated	241,131	243,816	5.45%	24-53
Morgan Stanley & Co., Incorporated	189,588	197,213	5.48%	12-39
WaMu Capital Corp.	17,850	18,417	5.61%	53
	1,989,928	2,033,418		
Total	\$ 2,114,734	\$ 2,193,307	5.50%	5-75

As of March 31, 2007, the maturity ranges of our outstanding repurchase agreements segregated by our available for sale securities and real estate loans are as follows:

Up to 30 days	31 to 90 days	Over 90 days	Total
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Agency RMBS	\$	781,049	\$	1,112,478	\$	1,893,527
Non-agency RMBS		23,270		1,899		25,169
CMBS				25,455		25,455
CDO		7,125				7,125
ABS		14,982		23,670		38,652
Real estate loans		124,806				124,806
Total	\$	951,232	\$	1,163,502	\$	2,114,734

In August 2005, we entered into a \$200,000 Master Repurchase Agreement (the Master Repurchase Agreement) with Wachovia Bank (the Bank). The Master Repurchase Agreement is for a two year term (expires August 2007) with a one year renewal option at the Bank s

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Crystal River Capital, Inc. and Subsidiaries

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6. DEBT AND OTHER FINANCING ARRANGEMENTS (Continued)

discretion. Subject to the terms and conditions thereof, the Master Repurchase Agreement provides for the purchase, sale and repurchase of commercial and residential mortgage loans, commercial mezzanine loans, B Notes, participation interests in the foregoing, commercial mortgage-backed securities and other mutually agreed upon collateral and bears interest at varying rates over LIBOR based upon the type of asset included in the repurchase obligation. In November 2005, the Bank increased the borrowing capacity to \$275,000. As of March 31, 2007, the unused amount under the Master Repurchase Agreement was \$275,000.

Collateralized Debt Obligations (CDOs) In November 2005, we issued approximately \$377,904 of CDOs through two newly-formed subsidiaries, Crystal River CDO 2005-1, Ltd. (the 2005 Issuer) and Crystal River CDO 2005-1 LLC (the 2005 Co-Issuer). The CDO consists of \$227,500 of investment grade notes and \$67,750 of non-investment grade notes, each with a final contractual maturity date of March 2046, which were co-issued by the 2005 Issuer and the 2005 Co-Issuer, and \$82,654 of preference shares, which were issued by the 2005 Issuer. We retained all of the non-investment grade securities, the preference shares and the common shares in the 2005 Issuer. The 2005 Issuer holds assets, consisting primarily of whole loans, CMBS and RMBS securities, which serve as collateral for the CDO. Investment grade notes in the aggregate principal amount of \$217,500 were issued with floating coupons with a combined weighted average interest rate of three-month LIBOR plus 0.58%. In addition, \$10,000 of investment grade notes were issued with a fixed coupon rate of 6.02%. The CDO may be replenished, pursuant to certain rating agency guidelines relating to credit quality and diversification, with substitute collateral for loans that are repaid during the first five years of the CDO. Thereafter, the CDO securities will be retired in sequential order from the senior-most to junior-most as loans are repaid. We incurred approximately \$5,906 of issuance costs, which is amortized over the average life of the CDO. The 2005 Issuer and 2005 Co-Issuer are consolidated in our financial statements. The investment grade notes are treated as a secured financing, and are non recourse to us. Proceeds from the sale of the investment grade notes issued were used to repay outstanding debt under our repurchase agreements. As of March 31, 2007, the CDO was collateralized by available for sale securities with a carrying value of \$247,965 and real estate loans with a carrying value of \$18,004.

In January 2007, we issued approximately \$390,338 of CDOs (CDO II) through two newly-formed subsidiaries, Crystal River Capital Resecuritization 2006-1 Ltd. (the 2006 Issuer) and Crystal River Capital Resecuritization 2006-1 LLC (the 2006 Co-Issuer). CDO II consists of \$324,956 of investment grade notes and \$14,638 of non-investment grade notes, which were co-issued by the 2006 Issuer and the 2006 Co-Issuer, and \$19,517 of non-investment grade notes and \$31,227 of preference shares, which were issued by the 2006 Issuer. The 2006 Issuer initially held cash totaling \$58,600 that was designated for the future funding of additional investments. As of March 31, 2007, \$16,498 of such cash remained uninvested and is reflected as restricted cash on our consolidated balance sheet. We retained all of the non-investment grade securities, the preference shares and the common shares in the 2006 Issuer. The 2006 Issuer holds assets, consisting of CMBS securities, which serve as collateral for CDO II. Investment grade notes in the aggregate principal amount of \$324,956 were issued with floating coupons with a combined weighted average interest rate of three-month LIBOR plus 0.57%. We incurred approximately \$6,006 of issuance costs, which will be amortized over the average life of CDO II. The 2006 Issuer and the 2006 Co-Issuer are consolidated in our financial

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6. DEBT AND OTHER FINANCING ARRANGEMENTS (Continued)

statements. The investment grade notes are treated as a secured financing, and are non recourse to us. Proceeds from the sale of the investment grade notes issued were used to repay outstanding debt under our repurchase agreements. CDO II was collateralized by available for sale securities. As of March 31, 2007, CDO II was collateralized by available for sale securities with a fair value of \$309,182.

Junior Subordinated Notes Held by Trust that Issued Trust Preferred Securities In March 2007, we formed Crystal River Preferred Trust I (Trust I) for the purpose of issuing trust preferred securities. In March 2007, Trust I issued \$50,000 of trust preferred securities to an unaffiliated investor and \$1,550 of trust common securities to us for \$1,550. The combined proceeds were invested by Trust I in \$51,550 of junior subordinated notes issued by us. The junior subordinated notes are the sole assets of Trust I and mature in April 2037, but are callable by us at par on or after April 2012. Interest is payable quarterly at a fixed rate of 7.68% (ten-year LIBOR plus 2.75%) through April 2012 and thereafter at a floating rate equal to three-month LIBOR plus 2.75%.

Mortgage Payable In March 2007, we financed a portion of our purchase of two office buildings located in Houston, Texas and Phoenix, Arizona, with a \$198,500 mortgage loan that bears interest at an annual rate of 5.509% and matures on April 1, 2017. The mortgage provides for payments of interest only throughout the term of the loan and the entire principal is due at maturity. We incurred financing costs of \$186, which have been deferred and are being amortized over the term of the loan.

Revolving Credit Facility In March 2006, we entered into an unsecured credit facility with Signature Bank that provides for borrowings of up to \$31,000 in the aggregate. The credit facility expires in March 2009. The credit facility provides for monthly repayments of all amounts due. Borrowings under the credit facility bear interest at a rate equal to the bank's prime interest rate or 1.75% over LIBOR. We had no amounts outstanding under this credit facility at March 31, 2007.

Restrictive Covenants and Maturities Certain of our repurchase agreements and our revolving credit facility contain financial covenants, including maintaining our REIT status and maintaining a specific net asset value or worth. We were in compliance with all our financial covenants as of December 31, 2006. As of March 31, 2007, with respect to one debt obligation, we failed to meet one financial covenant. We obtained a waiver with respect to the financial covenant that was not met. As a result, we were in compliance with or have obtained the necessary waivers with respect to all our financial covenants as of March 31, 2007.

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(unaudited)****6. DEBT AND OTHER FINANCING ARRANGEMENTS (Continued)***Interest Expense* Interest expense is comprised of the following:

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Interest on repurchase agreements	\$ 34,899	\$ 25,716
Interest on interest rate swap agreements	(2,866)	(581)
Interest on CDO notes	6,830	2,901
Interest on revolving credit facility		75
Interest on notes payable, related party		239
Amortization of deferred financing costs	621	484
Other	651	17
Total interest expense	\$ 40,135	\$ 28,851

Interest payable is comprised of the following:

	March 31, 2007	December 31, 2006
Interest on repurchase agreements	\$ 16,004	\$ 18,530
Interest on CDO notes	1,451	874
Other	128	13
Total interest payable	\$ 17,583	\$ 19,417

7. COMMITMENTS AND CONTINGENCIES

We invest in real estate construction loans. We had outstanding commitments to fund real estate construction loans in the aggregate of \$24,050 as of March 31, 2007. At March 31, 2007, we had made advances totaling \$22,387 under these commitments.

In January 2007, we made a \$28,462 investment in a private equity fund that invests in real estate investments. The fund is managed by an affiliate of our Manager and the investment was approved by the independent members of our board of directors. In connection with that investment, we agreed to a future capital commitment of \$10,392. In March 2007, we funded \$6,542 of such commitment. As of March 31, 2007, the unfunded commitment totaled \$3,850.

8. RISK MANAGEMENT TRANSACTIONS

Our objectives in using derivatives include reducing our exposure to interest expense movements through our use of interest rate swaps, reducing our exposure to foreign currency movements through our use of foreign currency swaps, and generating additional yield for investing through our use of credit default swaps.

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The fair value of our derivatives at March 31, 2007 and December 31, 2006 consisted of the following:

	March 31, 2007	December 31, 2006
Derivative Assets:		
Interest rate swaps	\$ 10,177	\$ 13,410
Interest rate caps	180	334
Foreign currency swaps	1,155	2,744
Credit default swaps	1,630	3,305
Interest receivable swap	1,053	1,072
Total derivative assets	\$ 14,195	\$ 20,865
Derivative Liabilities:		
Interest rate swaps	\$ 2,704	\$ 2,448
Foreign currency swaps	829	764
Credit default swaps	7,343	
Interest payable swap	6,261	7,936
Total derivative liabilities	\$ 17,137	\$ 11,148

The notional amount of our interest rate swap open positions and interest rate cap open positions as of March 31, 2007 and December 31, 2006 were as follows:

	March 31, 2007	December 31, 2006
Interest rate swaps on reverse repurchase agreements	\$ 1,215,433	\$ 1,285,433
Interest rate caps on reverse repurchase agreements	200,000	200,000
Interest rate swaps on CDO notes	51,494	52,069
Interest rate swaps on CDO II notes	240,467	240,467
	\$ 1,707,394	\$ 1,777,969

As of March 31, 2007 and December 31, 2006, we had unhedged repurchase agreements totaling \$699,301 and \$1,383,016, respectively.

The change in unrealized gains (loss) in interest rate swaps designated as cash flow hedges is separately disclosed in the statement of changes in stockholders' equity. As of March 31, 2007 and December 31, 2006, unrealized gains aggregating \$5,053 and \$7,169, respectively, on cash flow hedges were recorded in accumulated other comprehensive income (loss). The net realized losses on settled swaps for the three months ended March 31, 2007 and March 31, 2006 were \$2,738 and \$0, respectively, and are being amortized into income through interest expense. As of March 31, 2007 and December 31, 2006, the amount of net realized gains on settled swaps amortized from accumulated other comprehensive income (loss) into income was \$390 and \$310, respectively.

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The components of realized and unrealized (loss) gain on derivatives are as follows:

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Unrealized (loss) gain on credit default swaps (CDS)	\$ (5,367)	\$ 4,642
Unrealized (loss) gain on foreign currency swaps (FCS)	(1,654)	1,242
Unrealized (loss) gain on hedge ineffectiveness	(1,158)	61
Unrealized (loss) gain on economic hedges not designated for hedge accounting	(464)	1,623
Realized loss on settlement of swaps	(182)	
Premium earned from CDS	375	362
Net realized and unrealized (loss) gain on derivatives	\$ (8,450)	\$ 7,930

As of March 31, 2007 and December 31, 2006, we were required to provide additional collateral in respect of our interest rate swaps in the amount of \$12,378 and \$17,408, respectively, which is included in restricted cash on the balance sheet.

As of March 31, 2007, we held various credit default swaps, as the protection seller, with notional amount of \$160,000. A credit default swap (CDS) is a financial instrument used to transfer the credit risk of a reference entity from one party to another for a specified period of time. In a standard CDS contract, one party, referred to as the protection buyer, purchases credit default protection from another party, referred to as the protection seller, for a specific notional amount of obligations of a reference entity. In these transactions, the protection buyer pays a premium to the protection seller. The premium generally is paid monthly in arrears, but may be paid in full up front in the case of a CDS with a short maturity. Generally, if a credit event occurs during the term of the CDS, the protection seller pays the protection buyer the notional amount and takes delivery of the reference entity's obligation. CDS are generally unconditional, irrevocable and non-cancelable.

9. STOCKHOLDERS EQUITY AND LONG-TERM INCENTIVE PLAN

In March 2005, we completed the Private Offering in which we sold 17,400,000 shares of common stock, \$0.001 par value, at an offering price of \$25 per share, including the purchase of 400,000 shares of common stock by the initial purchasers/placement agents pursuant to an over-allotment option. We received proceeds from these transactions in

the amount of \$405,613, net of underwriting commissions, placement agent fees and other offering costs totaling \$29,387. In August 2006, we completed the Public Offering in which we sold 7,500,000 shares of common stock at an offering price of \$23 per share. The proceeds received from the Public Offering were \$158,599, which was net of underwriting and other offering costs of \$13,901. Each share of common stock entitles its holder to one vote per share. Officers, directors and entities affiliated with our Manager owned 1,996,967 shares of our common stock as of March 31, 2007.

In March 2005, we adopted a Long-Term Incentive Plan (the Plan) which provides for awards under the Plan in the form of stock options, stock appreciation rights, restricted and

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unrestricted stock awards, restricted stock units, deferred stock units and other performance awards. Our Manager and our officers, employees, directors, advisors and consultants who provide services to us are eligible to receive awards under the Plan. The Plan has a term of 10 years and, based on awards since adoption, limits awards through December 31, 2007 to a maximum of 2,502,180 shares of common stock. For subsequent periods, the maximum number of shares of common stock that may be subject to awards granted under the Plan can increase by 10% of the difference between the number of shares of common stock outstanding at the end of the current calendar year and the prior calendar year. In no event will the total number of shares that can be issued under the Plan exceed 10,000,000.

In connection with the Plan, a total of 84,000 shares of restricted common stock and 126,000 stock options (exercise price of \$25 per share) were granted to our Manager in March 2005. The Manager subsequently transferred these shares and options to certain of its officers and employees, certain of our directors and other individuals associated with our Manager who provide services to us. The restrictions on the restricted common stock lapse and full rights of ownership vest for one-third of the restricted shares and options on each of the first three anniversary dates of issuance. Vesting is predicated on the continuing involvement of our Manager in providing services to us. In addition, 3,500 shares of unrestricted stock were granted to the independent members of our board of directors in March 2005 in lieu of cash remunerations. The independent members of our board of directors fully vested in the shares on the date of grant.

During the three months ended March 31, 2007, we did not issue any shares of restricted common stock. In addition, for the three months ended March 31, 2007, we have issued 3,017 deferred stock units to certain independent members of our board of directors. Of this amount, 2,495 deferred stock units were issued in lieu of cash remunerations. These independent members of our board of directors fully vested in these units at the date of grant.

The fair value of unvested shares of the restricted stock issued to our Manager, directors and employees of our Manager's affiliates as of March 31, 2007 was \$1,351 and the fair value of unvested stock options granted as of March 31, 2007 was \$145 (\$3.35 per share). For the three months ended March 31, 2007 and March 31, 2006, \$319 and \$242 respectively, was expensed relating to the amortization of the restricted stock and the stock options. For the three months ended March 31, 2007 and March 31, 2006, \$120 and \$96, respectively, was expensed relating to the amortization of deferred stock units.

The Binomial option pricing model was used for pricing our stock options with the following assumptions as of March 31:

	2007	2006
Strike price	\$ 25.00	\$ 25.00
Dividend yield	10.13%	10.5%
Expected volatility	22.0%	22.0%

Risk free interest rate	5.0%	5.0%
Expected life of options	6 years	6 years

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Option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Our stock options have characteristics that are significantly different from those of traded options and changes in the subjective input assumptions could materially affect the fair value estimate.

Accumulated other comprehensive income (loss) as of March 31, 2007 and March 31, 2006 was comprised of the following:

	March 31, 2007	March 31, 2006
Net unrealized losses on available for sale securities	\$ (17,553)	\$ (34,863)
Net realized and unrealized gains on interest rate swap and cap agreements accounted for as cash flow hedges	4,408	21,773
Total other comprehensive income (loss)	\$ (13,145)	\$ (13,090)

10. FINANCIAL RISKS

We are subject to various risks, including credit, interest rate and market risk. We are subject to interest rate risk to the extent that our interest-bearing liabilities mature or re-price at different speeds, or different bases, than our interest-earning assets. Credit risk is the risk of default on our investments that results in a counterparty's failure to make payments according to the terms of the contract.

Market risk reflects changes in the value of the securities and real estate loans due to changes in interest rates or other market factors, including the rate of prepayments of principal and the value of the collateral underlying our available for sale securities and real estate loans.

As of March 31, 2007, the mortgage loans in the underlying collateral pools for all securities we owned were secured by properties predominantly in California (20%), Florida (9%), Arizona (7%), Texas (6%) and New York (5%). All other states are individually less than 5% as of March 31, 2007.

11. RELATED PARTY TRANSACTIONS

We have entered into a management agreement, as amended (the Agreement), with our Manager. The initial term of the Agreement expires in December 2008. After the initial term, the Agreement will be automatically renewed for a one-year term each anniversary date thereafter unless we or our Manager terminate the Agreement. The Agreement provides that our Manager will provide us with investment management services and certain administrative services

and will perform our day-to-day operations. The monthly base management fee for such services is equal to 1.5% of one-twelfth of our equity, as defined in the Agreement, payable in arrears.

In addition, under the Agreement, our Manager earns a quarterly incentive fee equal to 25% of the amount by which the quarterly net income per share, as defined in the Agreement (which principally excludes the effect of stock compensation and the unrealized change in

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(unaudited)**

11. RELATED PARTY TRANSACTIONS (Continued)

derivatives), exceeds an amount equal to the product of the weighted average of the price per share of the common stock we issued in the Private Offering and in the Public Offering and the price per share of common stock in any subsequent offerings by us, multiplied by the higher of (i) 2.4375% or (ii) 25% of the then applicable 10 year Treasury note rate plus 0.50%, multiplied by the then weighted average number of outstanding shares for the quarter. The incentive fee is paid quarterly. The Agreement provides that 10% of the incentive management fee is to be paid in shares of our common stock (providing that such payment does not result in our Manager owning directly or indirectly more than 9.8% of our issued and outstanding common stock) and the balance is to be paid in cash. Our Manager may, at its sole discretion, elect to receive a greater percentage of its incentive management fee in shares of our common stock. The incentive management fees included in our consolidated statements of income that were incurred during the three months ended March 31, 2007 and March 31, 2006 were \$124 and \$0, respectively.

The Agreement may be terminated upon the affirmative vote of at least two-thirds of the independent members of our board of directors after the expiration of the initial term and by providing at least 180 days prior notice based upon either: (i) unsatisfactory performance by our Manager that is materially detrimental to us, or (ii) a determination by the independent members of our board of directors that the management fees payable to our Manager are not fair (subject to our Manager's right to prevent a compensation termination by agreeing to a mutually acceptable reduction of the management fees). If we terminate the Agreement, then we must pay our Manager a termination fee equal to twice the sum of the average annual base and incentive fees earned by our Manager during the two twelve-month periods immediately preceding the date of termination, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination.

We issued to our Manager 84,000 shares of our restricted common stock and granted options to purchase 126,000 shares of our common stock for a 10 year period at a price of \$25 per share in March 2005. We issued to one of our executive officers 30,000 shares of restricted common stock in March 2006. The restricted stock and the options vest over a three-year period. We issued to one of our directors 2,000 shares of restricted stock in November 2006 that vest on the first anniversary of the date of issuance. For the three months ended March 31, 2007 and March 31, 2006, the base management expense was \$2,050 and \$1,455, respectively. Included in the management fee expense for the three months ended March 31, 2007 and March 31, 2006 is \$303 and \$222, respectively, of amortization of stock-based compensation related to restricted stock and options granted.

The Agreement provides that we are required to reimburse our Manager for certain expenses incurred by our Manager on our behalf provided that such costs and reimbursements are no greater than that which would be paid to outside professionals or consultants on an arm's length basis. For the three months ended March 31, 2007 and March 31, 2006, we did not incur any reimbursable costs due to our Manager.

In January 2007, we purchased a \$28,462 investment in BREF One, LLC (the Fund), a real estate finance fund sponsored by Brookfield Asset Management, and incurred a \$10,392 unfunded capital commitment to the Fund. The acquisition was made from two subsidiaries of Brookfield Asset Management. As of March 31, 2007, we had an unfunded capital commitment

Table of Contents**Crystal River Capital, Inc. and Subsidiaries****Notes to Consolidated Financial Statements
March 31, 2007****(in thousands, except share and per share data)
(unaudited)****11. RELATED PARTY TRANSACTIONS (Continued)**

of \$3,850 to the Fund. In addition, income from the equity investment in the Fund for the three months ended March 31, 2007 was \$849.

In February 2007, we entered into a sale and purchase agreement with BREOF BNK Fannin LP and BREOF BNK Phoenix LLC to acquire two commercial properties as described in Note 5 to these financial statements for a total value of \$235,805. We paid the purchase price for the properties with the proceeds from a \$198,500 mortgage loan from an external lender that bears interest at an annual rate of 5.509% and matures on April 1, 2017 and with available cash. In addition to the sale and purchase agreement, we entered into rent enhancement agreements with BREOF BNK Fannin LP and BREOF BNK Phoenix LLC under which we will receive monthly rent enhancement payments through 2015 totaling \$15,905.

The following amounts from related party transactions are included in our income statement for the three months ended March 31, 2007 and March 31, 2006:

	2007	2006
Interest income from real estate loans to related parties	\$ 600	\$ 582
Interest expense on indebtedness to related parties	2,121	600
Interest income from rent enhancement receivables from related parties	20	
Income from equity investment in private investment fund managed by related party	849	

The following amounts from related party transactions are included in our balance sheet as of March 31, 2007 and December 31, 2006:

	2007	2006
Real estate loans to related parties	\$ 43,327	\$ 42,885
Interest receivable from real estate loans to related parties	1,734	1,134
Interest payable on indebtedness to related parties	82	117
Rent enhancement receivable from related parties	13,617	
Investment in private investment fund managed by related party	35,892	

We and our Manager have entered into sub-advisory agreements with other affiliated entities and the fees payable under such agreements will be paid from any management fees earned by our Manager. In addition, certain of these affiliated sub-advisory entities introduced investments to us for purchase that we acquired for a total of \$262,705 and \$2,500 during the three months ended March 31, 2007 and March 31, 2006, respectively. The purchase price was determined at arm's length and the acquisition was approved in advance by the independent members of our board of

directors.

Table of Contents**Crystal River Capital, Inc. and Subsidiaries****Notes to Consolidated Financial Statements
March 31, 2007****(in thousands, except share and per share data)
(unaudited)****12. EARNINGS PER SHARE**

The following table sets forth the calculation of Basic and Diluted EPS for the three months ended March 31, 2007 and March 31, 2006 (in thousands, except share and per share amounts):

	Three Months Ended March 31, 2007			Three Months Ended March 31, 2006		
	Weighted Average Number		Per Share Amount	Weighted Average Number		Per Share Amount
	Net Income	of Shares Outstanding		Net Income	of Shares Outstanding	
Basic EPS:						
Net earnings per share of common stock	\$ 7,544	25,043,565	\$ 0.30	\$ 15,444	17,495,082	\$ 0.88
Effect of Dilutive Securities:						
Options outstanding for the purchase of common stock						
Diluted EPS:						
Net earnings per share of common stock and assumed conversions	\$ 7,544	25,043,565	\$ 0.30	\$ 15,444	17,495,082	\$ 0.88

13. INITIAL PUBLIC OFFERING

In August 2006, we completed the Public Offering, in which we sold 7,500,000 shares of common stock, \$0.001 par value, at an offering price of \$23 per share. We received proceeds from this transaction in the amount of \$162,409, net of underwriting commissions and discounts but before other offering costs in the amount of \$3,810. Each share of common stock entitles its holder to one vote per share. An affiliate of the parent of our Manager purchased 1,000,000 shares of our common stock in the Public Offering. After the transaction, our outstanding shares totaled 25,019,500.

14. SUBSEQUENT EVENTS

In April 2007, we issued \$115,000 of mortgage-backed notes through a newly-formed subsidiary, CRZ ABCP Financing LLC. We retained \$9,250 of senior subordinated mortgage-backed notes and \$4,250 of subordinated mortgage-backed notes. CRZ ABCP Financing LLC holds assets, consisting of commercial whole mortgage loans,

which serve as collateral for the mortgage-backed notes. Senior mortgage-backed notes in the aggregate principal amount of \$101,500 were issued with floating coupons with an interest rate of three-month LIBOR plus 0.35%. The senior mortgage-backed notes are treated as a secured financing, and are non recourse to us. Proceeds from the sale of the senior mortgage-backed notes issued were used to repay outstanding debt under our repurchase agreements.

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Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this Form 10-Q. Historical results set forth are not necessarily indicative of our future financial position and results of operations.

Overview

We are a specialty finance company formed on January 25, 2005 by Hyperion Brookfield Asset Management, Inc., which we refer to as Hyperion Brookfield, to invest in real estate-related securities and various other asset classes. We commenced operations in March 2005. We have elected and qualified to be taxed as a REIT for federal income tax purposes commencing with our taxable year ended December 31, 2005 and expect to qualify as a REIT in subsequent tax years. We invest in financial assets and intend to construct an investment portfolio that is leveraged where appropriate to seek to achieve attractive risk-adjusted returns and that is structured to comply with the various federal income tax requirements for REIT status and to qualify for an exclusion from regulation under the Investment Company Act of 1940, which we refer to as the Investment Company Act. Our current focus is on the following asset classes:

Real estate-related securities, principally RMBS and CMBS;

Whole mortgage loans, bridge loans, B Notes and mezzanine loans; and

Other ABS, including CDOs and consumer ABS.

We completed a private offering of 17,400,000 shares of our common stock in March 2005 in which we raised net proceeds of approximately \$405.6 million. We completed our initial public offering of 7,500,000 shares of our common stock, which we refer to as our IPO, in August 2006 in which we raised net proceeds of approximately \$158.6 million. We have fully invested the proceeds from the March 2005 private offering and our IPO, and, as of March 31, 2007, have a portfolio of MBS and other investments of approximately \$3.6 billion, which we intend to reallocate from time to time to achieve our optimal portfolio allocation at such time. We are externally managed by Hyperion Brookfield Crystal River Capital Advisors, LLC, which we refer to as Hyperion Brookfield Crystal River or our Manager. Hyperion Brookfield Crystal River is a wholly-owned subsidiary of Hyperion Brookfield.

We earn revenues and generate cash through our investments. We use a substantial amount of leverage to seek to enhance our returns. We finance each of our investments with different degrees of leverage. The cost of borrowings to finance our investments comprises a significant portion of our operating expenses. Our net income will depend, in large part, on our ability to control this particular operating expense in relation to our revenues.

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

interest rate trends,

rates of prepayment on mortgages underlying our MBS,

delinquency and loss trends in RMBS and our commercial real estate investments;

valuation of residential and commercial properties;

competition, and

other market developments.

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

our leverage,

our access to funding and borrowing capacity,

our borrowing costs,

our hedging activities,

the market value of our investments, and

REIT requirements and the requirements to qualify for an exemption from regulation under the Investment Company Act.

Our Business Model

Our interest and dividend income net of interest expense, which we refer to as our net interest and dividend income, is generated primarily from the net spread, or difference, between the interest income we earn on our investment portfolio and the cost of our borrowings and hedging activities. Our net interest and dividend income will vary based upon, among other things, the difference between the interest rates earned on our various interest-earning assets and the borrowing costs of the liabilities used to finance those investments. Other than our investments in Agency ARMS, we generally attempt to match fund our assets in order to match the maturity of the investments with the maturity of the financing sources used to make such investments. Although we do not match fund Agency ARMS due to their average 30 year maturities, we utilize interest rate swaps to hedge much of our interest rate exposure of these securities. We also utilize CDO financings, where match funding occurs as a result of cash flows from the collateral pool paying the interest on the debt securities issued by the CDO.

We anticipate that, for any period during which our assets are not match-funded, such assets could reprice slower or faster than the corresponding liabilities. Consequently, changes in interest rates, particularly short-term interest rates, may significantly influence our net income. Increases in these rates could tend to decrease our net income and the market value of our assets, and could possibly result in operating losses for us or limit or eliminate our ability to make distributions to our stockholders.

The yield on our assets may be affected by a difference between the actual prepayment rates and our projections. Prepayments on loans and securities may be influenced by changes in market interest rates and a variety of economic, geographic and other factors beyond our control, and consequently, such prepayment rates cannot be predicted with certainty. To the extent we have acquired assets at a premium or discount, a change in prepayment rates may affect our anticipated yield. Under certain interest rate and prepayment scenarios we may fail to recoup fully our cost of acquisition of certain assets.

In periods of declining interest rates, prepayments on our investments, including our RMBS, likely will increase. If we are unable to reinvest the proceeds of such prepayments at comparable yields, our net interest income may suffer. In periods of rising interest rates, prepayment rates on our investments, including our RMBS, will likely slow, causing the expected lives of these investments to increase. This may cause our net interest income to decrease as our borrowing and hedging costs rise while our interest income on those assets remains constant.

Although we use hedging to mitigate some of our interest rate risk, we do not hedge all of our exposure to changes in interest rates and prepayment rates, as there are practical limitations to our ability to insulate the portfolio from all of the negative consequences

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associated with changes in short-term interest rates while still seeking to provide an attractive net spread on our portfolio.

In addition, our returns will be affected by the credit performance of our non-agency investments. If credit losses on our investments or the loans underlying our investments increase, it may have an adverse affect on our performance.

Hyperion Brookfield Crystal River is entitled to receive a base management fee that is based on the amount of our equity (as defined in the management agreement), regardless of the performance of our portfolio. Accordingly, the payment of our management fee is a fixed cost and will not decline in the event of a decline in our profitability and may lead us to incur losses.

Trends

We believe the following trends may also affect our business:

Uncertain interest rate environment United States interest rates decreased modestly during the first quarter of 2007, as continued weakness in the economy fueled speculation of that the Federal Reserve will drop the rate on Federal Funds later in 2007. We believe that interest rates will decline as weakness in housing will slow the economy sufficiently to cause an ease in Monetary Policy.

With respect to our existing MBS portfolio, which is heavily concentrated in 3/1 and 5/1 hybrid adjustable rate RMBS, we have the risk that, on the one hand, interest rate increases could result in decreases in our net interest income, as there is a timing mismatch between the reset dates on our MBS portfolio and the financing of these investments. On the other hand, a decline in interest rates, although favorable in reducing our funding costs, might cause prepayments to rise rapidly, in which case we then would be in the position of having to reinvest at lower yields.

We currently have invested and intend to continue to invest in hybrid adjustable rate RMBS that are based on mortgages with periodic interest rate caps. The financing of these RMBS is short term in nature and does not include the benefit of an interest rate cap. This mismatch could result in a decrease in our net interest income if rates increase sharply after the initial fixed rate period and our interest cost increases more than the interest rate earned on our RMBS due to the related interest rate caps. With respect to our existing and future floating rate investments, we believe such interest rate increases could result in increases in our net interest income because our floating rate assets are greater in amount than the related liabilities.

However, we would expect that our fixed rate assets would decline in value in a rising interest rate environment and our net interest spreads on fixed rate assets could decline in a rising interest rate environment to the extent they are financed with floating rate debt. We have engaged in interest rate swaps to hedge a material portion of the risk associated with increases in interest rates. However, because we do not hedge 100% of the amount of short-term financing outstanding, increases in interest rates could result in a decline in the value of our portfolio, net of hedges. Similarly, decreases in interest rates could result in an increase in the value of our portfolio.

Weakness of sub-prime MBS market Continued declines in home price appreciation have weighed heavily on the sub-prime MBS market. In addition to rising delinquency across the highly leveraged loans to weaker borrowers, there has been a rising trend of first payment defaults on loans, which has created liabilities for loan originators. As a result, several prominent sub-prime lenders have closed down or filed for protection under the bankruptcy laws in early 2007. The deteriorating situation with loans and lenders has resulted in a complete dislocation in the capital markets associated with sub-prime MBS and ABS CDOs. In

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February 2007, the continued pressure on the ABX indices, which closed the month at all-time lows, filtered into the credit default swap, or CDS, markets, and finally into the CDO markets. Delinquency and performance problems real fundamental issues have finally had an impact on the price of CDO liabilities, and dramatically dampened the demand for sub-prime MBS securities.

Liquidity is the lifeblood of the mortgage business, and the decline in performance and profitability has not gone unnoticed by the new-issue securitization market. In March 2007, newly issued cash bonds had very limited demand, with most underwriter syndicate groups retaining a significant portion of the capital structure at pricing, even with yield spreads much wider. Further, there has been a substantial widening of yield spreads, including in non-agency prime MBS and CMBS, as buyers demand more compensation for risk. The increase in risk premium and the increase in liquidity premium has resulted in a significant mark-to-market adjustment for most sub-prime floating-rate MBS. As of March 31, 2007, we had \$104.9 million of exposure to the sub-prime market that is exposed to the widening yield spreads and declining prices. As this scenario plays out, we expect significant opportunity in the sub-prime MBS sector on deeply discounted securities.

Flattening/Inverting yield curve Recently, short term interest rates have been unchanged while longer term interest rates have fallen. For example, between December 31, 2006 and March 31, 2007, the yield on the three-month U.S. Treasury bill was unchanged, while the yield on the three-year U.S. Treasury note fell by approximately 20 basis points. With respect to our MBS portfolio, we believe that a continued inversion of the yield curve could result in decreases in our net interest income, as the financing of our MBS investments is usually shorter in term than the fixed rate period of our MBS portfolio, which is heavily weighted toward 3/1 and 5/1 hybrid adjustable rate RMBS. Similarly, we believe that a steepening of the yield curve could result in increases in our net interest income. A flattening of the shape of the yield curve results in a smaller gap between the rate we pay on the swaps and rate we receive. Furthermore, a continued flattening of the shape of the yield curve could result in a decrease in our hedging costs, because we pay a fixed rate and receive a floating rate under the terms of our swap agreements. Similarly, a steepening of the shape of the yield curve could result in an increase in our hedging costs.

Prepayment rates As interest rates fall, we believe that prepayment rates are likely to rise. Prepayment rates on fixed rate mortgages generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates for the hybrid ARMS that constitute the majority of our MBS investments are more difficult to predict. Prepayment rates also may be affected by other factors, including, without limitation, conditions in the housing and financial markets, general economic conditions and the relative interest rates on adjustable-rate and fixed-rate mortgage loans. If interest rates begin to fall, triggering an increase in prepayment rates, our current portfolio, which is heavily weighted towards hybrid adjustable-rate mortgages, could cause decreases in our net interest income relating to our MBS portfolio as we reinvest at lower yields.

Competition We expect to face increased competition for our targeted investments. However, we expect that the size and growth of the market for these investments will continue to provide us with a variety of investment opportunities. In addition, we believe that bank lenders will continue their historical lending practices, requiring low loan-to-value ratios and high debt service coverages, which will provide opportunities to lenders like us to provide corporate mezzanine financing.

For a discussion of additional risks relating to our business see the risk factors disclosed under Part I, Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006, a copy of which is filed as Exhibit 99.1 to this report.

Table of Contents**Critical Accounting Policies**

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. These accounting principles require us to make some complex and subjective decisions and assessments. These include fair market value of certain assets, amount and timing of credit losses, prepayment assumptions, and other items that affect the reported amounts of certain assets and liabilities as of the date of the consolidated financial statements and the reported amounts of certain revenues and expenses during the reported period. It is likely that changes in these estimates (*e.g.*, market values change due to changes in supply and demand, credit performance, prepayments, interest rates, or other reasons; yields change due to changes in credit outlook and loan prepayments) will occur in the near future. Our most critical accounting policies involve decisions and assessments that could affect our reported assets and liabilities as well as our reported revenues and expenses. We believe that all of the decisions and assessments upon which our financial statements are based were reasonable at the time made based upon information available to us at that time. We rely on the experience of Hyperion Brookfield and Crystal River's management and its analysis of historical and current market data in order to arrive at what we believe to be reasonable estimates. See Note 2 to our consolidated financial statements contained elsewhere herein for a complete discussion of our accounting policies. Our estimates are inherently subjective in nature and actual results could differ from our estimates and differences may be material. We have identified our most critical accounting policies to be the following:

Investment Consolidation

For each investment we make, we evaluate the underlying entity that issued the securities we acquired or to which we made a loan in order to determine the appropriate accounting. We refer to guidance in Statement of Financial Accounting Standards (SFAS) No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS 140), and FASB Interpretation No. (FIN) 46R, *Consolidation of Variable Interest Entities* (FIN 46R), in performing our analysis. FIN 46R addresses the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, to certain entities in which voting rights are not effective in identifying an investor with a controlling financial interest. An entity is subject to consolidation under FIN 46R if the investors either do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support, are unable to direct the entity's activities, or are not exposed to the entity's losses or entitled to its residual returns (variable interest entities or VIEs). Variable interest entities within the scope of FIN 46R are required to be consolidated by their primary beneficiary. The primary beneficiary of a VIE is determined to be the party that absorbs a majority of the VIE's expected losses, receives the majority of the VIE's expected returns, or both.

Our ownership of the subordinated classes of CMBS and RMBS from a single issuer may provide us with the right to control the foreclosure/workout process on the underlying loans, which we refer to as the Controlling Class CMBS and RMBS. There are certain exceptions to the scope of FIN 46R, one of which provides that an investor that holds a variable interest in a qualifying special-purpose entity (QSPE) is not required to consolidate that entity unless the investor has the unilateral ability to cause the entity to liquidate. SFAS 140 sets forth the requirements for an entity to qualify as a QSPE. To maintain the QSPE exception, the special-purpose entity must initially meet the QSPE criteria and must continue to satisfy such criteria in subsequent periods. A special-purpose entity's QSPE status can be impacted in future periods by activities undertaken by its transferor(s) or other involved parties, including the manner in which certain servicing activities are performed. To the extent that our CMBS or RMBS investments were issued by a special-purpose entity that meets the QSPE requirements, we record those investments at the purchase price paid. To the extent the underlying special-

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purpose entities do not satisfy the QSPE requirements, we follow the guidance set forth in FIN 46R as the special-purpose entities would be determined to be VIEs.

We have analyzed the pooling and servicing agreements governing each of our Controlling Class CMBS and RMBS investments and we believe that the terms of those agreements are industry standard and are consistent with the QSPE criteria. However, there is uncertainty with respect to QSPE treatment for those special-purpose entities due to ongoing review by regulators and accounting standard setters (including the project of the Financial Accounting Standards Board (FASB) to amend SFAS 140 and the recently added FASB project on servicer discretion in a QSPE), potential actions by various parties involved with the QSPE (discussed in the paragraph above) and varying and evolving interpretations of the QSPE criteria under SFAS 140. We also have evaluated each of our Controlling Class CMBS and RMBS investments for which we own a greater than 50% interest in the subordinated class as if the special-purpose entities that issued such securities are not QSPEs. Using the fair value approach to calculate expected losses or residual returns, we have concluded that we would not be the primary beneficiary of any of the underlying special-purpose entities. Additionally, the standard setters continue to review the FIN 46R provisions related to the computations used to determine the primary beneficiary of VIEs. Future guidance from regulators and standard setters may require us to consolidate the special-purpose entities that issued the CMBS and RMBS in which we have invested as described in the section titled Variable Interest Entities in Note 2 to our consolidated financial statements included elsewhere herein.

Our maximum exposure to loss as a result of our investment in these QSPEs totaled \$238.3 million as of March 31, 2007.

Trust Preferred Securities

Trusts that we form for the sole purpose of issuing trust preferred securities are not consolidated in our financial statements in accordance with FIN 46R as we have determined that we are not the primary beneficiary of such trusts. Our investment in the common securities of such trusts is included in other assets in our consolidated financial statements.

Revenue Recognition

The most significant source of our revenue comes from interest income on our securities and loan investments. Interest income on loans and securities investments is recognized over the life of the investment using the effective interest method. Mortgage loans will generally be originated or purchased at or near par value and interest income will be recognized based on the contractual terms of the debt instrument. Any loan fees or acquisition costs on originated loans will be deferred and recognized over the term of the loan as an adjustment to the yield. Interest income on MBS is recognized on the effective interest method as required by Emerging Issues Task Force (EITF) 99-20, *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets* (EITF 99-20). Under EITF 99-20, management estimates, at the time of purchase, the future expected cash flows and determines the effective interest rate based on these estimated cash flows and our purchase prices. Subsequent to the purchase and on a quarterly basis, these estimated cash flows are updated and a revised yield is calculated based on the current amortized cost of the investment. In estimating these cash flows, there are a number of assumptions that are subject to uncertainties and contingencies. These include the rate and timing of principal payments (including prepayments, repurchases, defaults and liquidations), the pass through or coupon rate and interest rate fluctuations. In addition, interest payment shortfalls have to be estimated due to delinquencies on the underlying mortgage loans and the timing and magnitude of credit losses on the mortgage loans underlying the securities. These uncertainties and contingencies are difficult to predict and are subject to future events that may affect management's estimates and our interest income. When current period cash flow estimates are lower than the

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previous period and fair value is less than an asset's carrying value, we will write down the asset to fair market value and record an impairment charge in current period earnings.

Through its extensive experience in investing in MBS, Hyperion Brookfield has developed models based on historical data in order to estimate the lifetime prepayment speeds and lifetime credit losses for pools of mortgage loans. The models are based primarily on loan characteristics, such as loan-to-value ratios (LTV), borrower credit scores, loan type, loan rate, property type, etc., and also include other qualitative factors such as the loan originator and servicer. Once the models have been used to project the base case prepayment speeds and to project the base case cumulative loss, those outputs are used to create yield estimates and to project cash flows.

Because mortgage assets amortize over long periods of time (*i.e.*, 25 to 30 years in the case of RMBS assets or 10 years in the case of CMBS assets), the expected lifetime prepayment experience and the expected lifetime credit losses projected by the models are subject to modification in light of actual experience assessed from time to time. For each of the purchased mortgage pools, our Manager tracks the actual monthly prepayment experience and the monthly loss experience, if any. To the extent that the actual performance trend over a 6-12 month period of time does not reasonably approximate the expected lifetime trend, in consideration of the seasoning of the asset, our Manager may make adjustments to the assumptions and revise yield estimates and projected cash flows.

We have retained substantially all of the risks and benefits of ownership of our rental properties and therefore we account for leases with our tenants as operating leases. The total amount of contractual rent that we receive from operating leases is recognized on a straight-line basis over the term of the lease; and a straight-line or free rent receivable, as applicable, is recorded for the difference between the rental revenue recorded and the contractual amount received. In addition to base rent, the tenants in our commercial real estate properties also pay substantially all operating costs.

Loan Loss Provisions

We purchase and originate mezzanine loans and commercial mortgage loans to be held as long-term investments. We evaluate each of these loans for possible impairment on a quarterly basis. Impairment occurs when it is deemed probable that we will not be able to collect all amounts due according to the contractual terms of the loan. Upon determination of impairment, we will establish a reserve for loan losses and a corresponding charge to earnings through the provision for loan losses. Significant judgments are required in determining impairment, which include assumptions regarding the value of the real estate or partnership interests that secure the mortgage loans.

Valuations of MBS and ABS

Our MBS and ABS have fair values as determined with reference to price estimates provided by independent pricing services and dealers in the securities. Different judgments and assumptions used in pricing could result in different estimates of value.

When the fair value of an available-for-sale security is less than its amortized cost for an extended period, we consider whether there is an other-than-temporary impairment in the value of the security. If, in our judgment, an other-than-temporary impairment exists, the cost basis of the security is written down to the then-current fair value, and the unrealized loss is transferred from accumulated other comprehensive loss as an immediate reduction of current earnings (as if the loss had been realized in the period of other-than-temporary impairment). The determination of other-than-temporary impairment is a subjective process, and different judgments and assumptions could affect the timing of loss realization.

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We consider the following factors when determining an other-than-temporary impairment for a security or investment:

The length of time and the extent to which the market value has been less than the amortized cost;

Whether the security has been downgraded by a rating agency; and

Our intent to hold the security for a period of time sufficient to allow for any anticipated recovery in market value.

Periodically, all available for sale securities are evaluated for other than temporary impairment in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115), and Emerging Issues Task Force No. 99-20, *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interest in Securitized Financial Assets* (EITF 99-20). An impairment that is an other than temporary impairment is a decline in the fair value of an investment below its amortized cost attributable to factors that indicate the decline will not be recovered over the investment's remaining life. Other than temporary impairments result in reducing the security's carrying value to its fair value through the statement of income, which also creates a new carrying value for the investment. We compute a revised yield based on the future estimated cash flows as described in Revenue Recognition above. Significant judgments are required in determining impairment, which include making assumptions regarding the estimated prepayments, loss assumptions and the changes in interest rates.

The determination of other-than-temporary impairment is made at least quarterly. If we determine an impairment to be other than temporary we will need to realize a loss that would have an impact on future income. Under the guidance provided by SFAS 115, a security is impaired when its fair value is less than its amortized cost and we do not intend to hold that security until we recover its amortized cost or until its maturity. At March 31, 2007, we had the positive intent and ability to hold our available for sale securities. For the three months ended March 31, 2007, we did not identify any securities that were determined to be impaired under the guidance provided by SFAS 115. In addition, we recorded an impairment charge on four RMBS securities under EITF 99-20 in the amount of \$0.6 million for the three months ended March 31, 2007. As of March 31, 2007, we still owned all four of those securities.

Commercial Real Estate

Commercial properties held for investment are carried at cost less accumulated depreciation. In accordance with SFAS No. 141, *Business Combinations*, upon acquisition, we allocate the purchase price to the components of the commercial properties acquired: the amount allocated to land is based on its estimated fair value; buildings and existing tenant improvements are recorded at depreciated replacement cost; above- and below-market in-place operating leases are determined based on the present value of the difference between the rents payable under the contractual terms of the leases and estimated market rents; lease origination costs for in-place operating leases are determined based on the estimated costs that would be incurred to put the existing leases in place under the same terms and conditions; and tenant relationships are measured based on the present value of the estimated avoided net costs if a tenant were to renew its lease at expiry, discounted by the probability of such renewal.

We have retained substantially all of the risks and benefits of ownership of our rental properties and therefore we account for leases with our tenants as operating leases. The total amount of contractual rent that we receive from operating leases is recognized on a straight-line basis over the term of the lease; and a straight-line or free rent receivable, as applicable, is

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recorded for the difference between the rental revenue recorded and the contractual amount received.

Depreciation on buildings is provided on a straight-line basis over the useful lives of the properties to a maximum of 40 years. Depreciation is determined with reference to each rental property's carried value, remaining estimated useful life and residual value. Acquired tenant improvements, above- and below-market in-place operating leases and lease origination costs are amortized on a straight-line basis over the remaining terms of the leases. The value associated with acquired tenant relationships is amortized on a straight-line basis over the expected term of the relationships. All other tenant improvements and re-leasing costs are deferred and amortized on a straight-line basis over the terms of the leases to which they relate. Depreciation on buildings and amortization of deferred leasing costs and tenant improvements that are determined to be assets of the company are recorded in depreciation and amortization expense. All above- and below-market tenant leases and tenant relationships are amortized to revenue. Above- and below-market ground leases are amortized to operating expenses.

Properties are reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. For commercial properties, an impairment loss is recognized when a property's carrying value exceeds its undiscounted future net cash flow. The impairment is measured as the amount by which the carrying value exceeds the estimated fair value. Projections of future cash flow take into account the specific business plan for each property and management's best estimate of the most probable set of economic conditions anticipated to prevail in the market.

Accounting For Derivative Financial Instruments and Hedging Activities

Our policies permit us to enter into derivative contracts, including interest rate swaps, currency swaps, interest rate caps and interest rate swap forwards, as a means of mitigating our interest rate risk on forecasted interest expense associated with the benchmark rate on forecasted rollover/reissuance of repurchase agreements, or hedged items, for a specified future time period. We currently intend to use interest rate derivative instruments to mitigate interest rate risk rather than to enhance returns.

At March 31, 2007, we were a party to 36 interest rate swaps and caps with a notional par value of approximately \$1,707.4 million that had a net fair value of approximately \$7.7 million, which is included in our derivative assets. We entered into these interest rate swaps and caps to seek to mitigate our interest rate risk for the specified future time period, which is defined as the term of the swap and cap contracts. Based upon the market value of these interest rate swap and cap contracts, our counterparties may request additional margin collateral or we may request additional collateral from our counterparties to ensure that an appropriate margin account balance is maintained at all times through the expiration of the contracts.

At March 31, 2007, we were a party to two currency swaps with a notional par value of approximately Can\$50.0 million and £10.0 million that had a net fair value of approximately \$0.3 million, which is included in our derivative assets. We entered into these currency swaps to seek to mitigate our currency risk for the specified future time period, which is defined as the term of the swap contracts. Based upon the market value of these currency swap contracts, our counterparties may request additional margin collateral or we may request additional collateral from our counterparties to ensure that an appropriate margin account balance is maintained at all times through the expiration of the contracts.

As of March 31, 2007, we had six CDS with a notional par value of \$55.0 million that are reflected on our balance sheet as a derivative asset at their fair value of approximately \$1.6 million and eight CDS with a notional par value of \$105.0 million that are reflected on our balance sheet as a derivative liability at their fair value of approximately \$7.3 million. The fair

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value of the CDS depends on a number of factors, primarily premium levels, which are dependent on interest rate spreads. The CDS contracts are valued using internally developed and tested market-standard pricing models that calculate the net present value of differences between future premiums on currently quoted market CDS and the contractual future premiums on our CDS contracts.

We account for derivative and hedging activities in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (SFAS 133). SFAS 133 requires recognizing all derivative instruments as either assets or liabilities in the balance sheet at fair value. The accounting for changes in fair value (*i.e.*, gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, we must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation. We have no fair value hedges or hedges of a net investment in foreign operations.

For derivative instruments that are designated and qualify as a cash flow hedge (*i.e.*, hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings (for example, in interest expense when the hedged transactions are interest cash flows associated with floating-rate debt). The remaining gain (loss) on the derivative instrument in excess of the cumulative changes in the present value of future cash flows of the hedged item, if any, is recognized in the realized and unrealized gain (loss) on derivatives in current earnings during the period of change. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in realized and unrealized gain (loss) on derivatives in the current earnings during the period of change. Income and/or expense from interest rate swaps are recognized as a net adjustment to interest expense. We account for income and expense from interest rate swaps on an accrual basis over the period to which the payment and/or receipt relates.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires us to make a significant number of estimates in the preparation of the financial statements. These estimates include determining the fair market value of certain investments and derivative liabilities, amount and timing of credit losses, prepayment assumptions, allocation of purchase price to tangible and intangible assets on property acquisitions, and other items that affect the reported amounts of certain assets and liabilities as of the date of the consolidated financial statements and the reported amounts of certain revenues and expenses during the reported period. It is likely that changes in these estimates (*e.g.*, market values change due to changes in supply and demand, credit performance, prepayments, interest rates, or other reasons; yields change due to changes in credit outlook and loan prepayments) will occur in the near future. Our estimates are inherently subjective in nature and actual results could differ from our estimates and differences may be material.

Share-Based Payment

We account for share-based compensation issued to members of our board of directors, our Manager and certain of our senior executives using the fair value based methodology in accordance with SFAS No. 123R, *Accounting for Stock Based Compensation* (SFAS 123R). We do not have any employees, although we believe that members of our board of directors are deemed to be employees for purposes of interpreting and applying accounting principles

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relating to share-based compensation. We record as compensation costs the restricted common stock that we issued to members of our board of directors at fair value as of the grant date and we amortize the cost into expense over the applicable vesting period using the straight-line method. We recorded compensation costs for restricted common stock and common stock options that we issued to our Manager and that were reallocated to employees of our Manager and its affiliates that provide services to us at fair value as of the grant date and we remeasure the amount on subsequent reporting dates to the extent that the restricted common stock and/or common stock options are unvested. Prior to our initial public offering and listing on the New York Stock Exchange, unvested restricted stock was valued using appraised value, and subsequent to our initial public offering and listing, we used the closing price as reported on the New York Stock Exchange. Unvested common stock options are valued using a Binomial pricing model and assumptions based on observable market data for comparable companies. The assumptions we use in determining share based compensation, including expected stock price volatility, dividend yield, risk free interest rate and the expected life of the options, are subject to judgments and the results of our operations would change if different assumptions were utilized. We amortize compensation expense related to the restricted common stock and common stock options that we granted to our Manager using the graded vesting attribution method in accordance with SFAS 123R.

Because we remeasure the amount of compensation costs associated with the unvested restricted common stock and unvested common stock options that we issued to our Manager and certain of our senior executives as of each reporting period, our share-based compensation expense reported in our statements of operations will change based on the fair value of our common stock and this may result in earnings volatility.

Interest in Equity Investment

We account for our investment in BREF One, LLC, a real estate finance fund, under the equity method of accounting since we own more than a minor interest in the fund, but do not unilaterally control the fund and are not considered to be the primary beneficiary under FIN 46R. The investment was recorded initially at cost, and subsequently adjusted for equity in net income (loss) and cash contributions and distributions.

Income Taxes

We operate in a manner that we believe will allow us to be taxed as a REIT and, as a result, we do not expect to pay substantial corporate-level income taxes. Many of the requirements for REIT qualification, however, are highly technical and complex. If we were to fail to meet these requirements and do not qualify for certain statutory relief provisions, we would be subject to federal income tax, which could have a material adverse impact on our results of operations and amounts available for distributions to our stockholders. In addition, Crystal River TRS Holdings, Inc., our TRS, is subject to corporate-level income taxes.

Our policy for interest and penalties on material uncertain tax positions recognized in our consolidated financial statements is to classify these as interest expense and operating expense, respectively. However, in accordance with Financial Interpretation Number 48, *Accounting for Uncertainty in Income Taxes*, (FIN 48) we assessed our tax positions for all open tax years (Federal, years 2005 to 2006 and State, years 2005 to 2006) as of March 31, 2007 and concluded that we have no material FIN 48 liabilities to be recognized at this time.

Financial Condition

All of our assets at March 31, 2007 were acquired with the net proceeds of approximately \$405.6 million from our March 2005 private offering of 17,400,000 shares of our common stock, the net proceeds of approximately \$158.6 million from our August 2006 initial public offering of 7,500,000 shares of our common stock, the net proceeds of approximately \$48.6 million from our March 2007 issuance of trust preferred securities and our use of

leverage.

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Some of our mortgage investment strategy involves buying higher coupon, higher premium dollar priced bonds, which takes on more prepayment risk (particularly call or prepayment risk) than lower dollar-priced strategies. However, we believe that the potential benefits of this strategy include higher income, wider spreads, and lower hedging costs due to the shorter option-adjusted duration of the higher coupon security.

The table below summarizes our MBS investments at March 31, 2007:

	RMBS	CMBS
	(in thousands)	
Amortized cost	\$ 2,295,758	\$ 497,819
Unrealized gains	9,658	5,717
Unrealized losses	(23,875)	(10,230)
Fair value	\$ 2,281,541	\$ 493,306

As of March 31, 2007, the RMBS and CMBS in our portfolio were purchased at a net discount to their par value and our portfolio had a weighted average amortized cost of 97.4% and 71.2% of face amount, respectively. The RMBS and CMBS were valued below par at March 31, 2007 because we are investing in lower-rated bonds in the credit structure. Certain of the securities held at March 31, 2007 are valued below cost. Other than securities with respect to which impairments have been recorded, we do not believe any such securities are other than temporarily impaired at March 31, 2007.

Our MBS holdings were as follows at March 31, 2007:

	Estimated	Percent	Weighted Average		Constant	
	Asset	of	Months	Yield to	Prepayment	
	Value(1)	Total	to	Maturity	Rate(3)	
	(in	Investments	Reset(2)			
	thousands)	Coupon				
RMBS:						
Non-Agency Prime MBS:						
5/1 adjustable rate	\$	%	%		%	
Investment grade	15,521	0.5	5.64	49.74	7.30	36.91
Below investment grade	150,288	4.5	7.19	13.37	27.51	42.34
Non-Agency Sub-prime MBS:						
Investment grade	65,438	1.9	7.17	7.53	13.37	29.26
Below investment grade	39,458	1.2	7.99	3.25	29.68	31.67
Agency:						
3/1 hybrid adjustable rate	579,048	17.3	5.18	20.63	5.29	43.61

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5/1 hybrid adjustable rate	1,431,788	42.8	5.37	40.14	5.16	40.93
Total RMBS	\$ 2,281,541	68.2%	5.60	31.62	7.34	41.11
CMBS:						
Investment grade CMBS	\$ 250,766	7.5%	5.72		6.53	
Below investment grade CMBS	242,540	7.3	4.97		12.11	
Total CMBS	\$ 493,306	14.8%	5.25		9.28	

(1) All securities listed in this chart are carried at their estimated fair value.

(2) Represents number of months before conversion to floating rate.

(3) Represents the estimated percentage of principal that will be prepaid over the next 12 months based on historical principal paydowns.

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The estimated weighted average lives of the MBS in the tables above are based upon our prepayment expectations, which are based on both proprietary and subscription-based financial models.

Our prepayment projections consider current and expected trends in interest rates, interest rate volatility, steepness of the yield curve, the mortgage rate of the outstanding loan, time to reset and the spread margin of the reset.

The table below summarizes the credit ratings of our MBS investments at March 31, 2007:

	RMBS	CMBS
	(in thousands)	
AAA	\$ 2,010,836	\$
AA		
A	27,288	
BBB	52,115	250,766
BB	96,701	121,809
B	64,739	65,609
Not rated	29,862	55,122
Total	\$ 2,281,541	\$ 493,306

Actual maturities of RMBS are generally shorter than stated contractual maturities, as they are affected by the contractual lives of the underlying mortgages, periodic payments of principal, and prepayments of principal. The stated contractual final maturity of the mortgage loans underlying our portfolio of RMBS ranges up to 30 years, but the expected maturity is subject to change based on the prepayments of the underlying loans. As of March 3, 2007, the average final contractual maturity of the mortgage portfolio is 2036.

The constant prepayment rate, or CPR, attempts to predict the percentage of principal that will be prepaid over the next 12 months based on historical principal paydowns. As interest rates rise, the rate of refinancings typically declines, which we believe may result in lower rates of prepayment and, as a result, a lower portfolio CPR.

As of March 31, 2007, some of the mortgages underlying our RMBS had fixed interest rates for the weighted average lives of approximately 32 months, after which time the interest rates reset and become adjustable. The average length of time until contractual maturity of those mortgages as of March 31, 2007 was 30 years.

After the reset date, interest rates on our hybrid adjustable rate RMBS securities float based on spreads over various LIBOR and Treasury indices. These interest rates are subject to caps that limit the amount the applicable interest rate can increase during any year, known as an annual cap, and through the maturity of the applicable security, known as a lifetime cap. The weighted average annual cap for the portfolio is an increase of 1.97%; the weighted average maximum increases and decreases for the portfolio are 5.02%. Additionally, the weighted average maximum increases and decreases for agency hybrid RMBS in the first year that the rates are adjustable are 3.05%.

which are not expected to be met. We have commenced negotiations with the senior lender and the developer regarding the developer's need to obtain additional financing to cover these additional construction costs.

We have evaluated the financial merits of the project by reviewing the projected unit sales, estimating construction costs and evaluating other collateral available to us under the terms of

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the loan. Our management believes that it is probable that the entire loan balance, including the capitalized interest, will be recovered through the satisfaction of future cash flows from sales and other available collateral. Accordingly, we have not recorded any impairment related to this loan. We will continue to monitor the status of this loan and we intend to work with the borrower and the senior lender to recover the outstanding loan balance. However, housing prices, in particular condominium prices, may fall, unit sales may lag projections and construction costs may increase, all of which may increase the risk of impairment to our loan. No assurance can be given that this loan will not be impaired in the future depending on the outcome of future events, including the outcome of negotiations with the senior lender and the borrower. In the event that we determine that it is probable that we will not be able to recover the total outstanding principal and interest due on this loan, we will reevaluate whether the loan is impaired.

Commercial Real Estate

At March 31, 2007, our commercial real estate is reported at cost, net of accumulated depreciation. In accordance with SFAS No. 141, *Business Combinations*, upon acquisition, we allocate the purchase price to the components of the commercial properties acquired: the amount allocated to land is based on its estimated fair value; buildings and existing tenant improvements are recorded at depreciated replacement cost; above- and below-market in-place operating leases are determined based on the present value of the difference between the rents payable under the contractual terms of the leases and estimated market rents; lease origination costs for in-place operating leases are determined based on the estimated costs that would be incurred to put the existing leases in place under the same terms and conditions; and tenant relationships are measured based on the present value of the estimated avoided net costs if a tenant were to renew its lease at expiry, discounted by the probability of such renewal.

Depreciation on buildings is provided on a straight-line basis over the useful lives of the properties to a maximum of 40 years. Depreciation is determined with reference to each rental property's carried value, remaining estimated useful life and residual value. Acquired tenant improvements, above- and below-market in-place operating leases and lease origination costs are amortized on a straight-line basis over the remaining terms of the leases. The value associated with acquired tenant relationships is amortized on a straight-line basis over the expected term of the relationships. All other tenant improvements and re-leasing costs are deferred and amortized on a straight-line basis over the terms of the leases to which they relate. Depreciation on buildings and amortization of deferred leasing costs and tenant improvements that are determined to be assets of the company are recorded in depreciation and amortization expense. All above- and below-market tenant leases and tenant relationships are amortized to revenue. Above- and below-market ground leases are amortized to operating expenses.

Properties are reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. For commercial properties, an impairment loss is recognized when a property's carrying value exceeds its undiscounted future net cash flow. The impairment is measured as the amount by which the carrying value exceeds the estimated fair value. Projections of future cash flow take into account the specific business plan for each property and management's best estimate of the most probable set of economic conditions anticipated to prevail in the market.

Interest and Principal Paydown Receivable

At March 31, 2007, we had interest and principal paydown receivables of approximately \$22.9 million, \$0.4 million of which related to interest that had accrued on securities prior to our purchase of such securities. The total interest and principal paydown receivable amount

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consisted of approximately \$16.5 million relating to our MBS and approximately \$6.4 million relating to other investments.

Hedging Instruments and Derivative Activities

There can be no assurance that our hedging activities will have the desired beneficial impact on our results of operations or financial condition. Moreover, no hedging activity can completely insulate us from the risks associated with changes in interest rates and prepayment rates. We generally intend to hedge as much of the interest rate risk as Hyperion Brookfield Crystal River determines is in the best interests of our stockholders, after considering the cost of such hedging transactions and our desire to maintain our status as a REIT. Our policies do not contain specific requirements as to the percentages or amount of interest rate risk that our manager is required to hedge.

As of March 31, 2007, we had engaged in interest rate swaps and interest rate swap forwards as a means of mitigating our interest rate risk on forecasted interest expense associated with repurchase agreements for a specified future time period, which is the term of the swap contract. An interest rate swap is a contractual agreement entered into by two counterparties under which each agrees to make periodic payments to the other for an agreed period of time based upon a notional amount of principal. Under the most common form of interest rate swap, a series of payments calculated by applying a fixed rate of interest to a notional amount of principal is exchanged for a stream of payments similarly calculated but using a floating rate of interest. This is a fixed-floating interest rate swap. We hedge our floating rate debt by entering into fixed-floating interest rate swap agreements whereby we swap the floating rate of interest on the liability we are hedging for a fixed rate of interest. An interest rate swap forward is an interest rate swap based on an interest rate to be set at an agreed future date. As of March 31, 2007, we were a party to interest rate swaps and caps with maturities ranging from November 2007 to July 2021 with a notional par amount of approximately \$1,707.4 million. Under the swap agreements in place at March 31, 2007, we receive interest at rates that reset periodically, generally every three months, and pay a rate fixed at the initiation of and for the life of the swap agreements. The current market value of interest rate swaps is heavily dependent on the current market fixed rate, the corresponding term structure of floating rates (known as the yield curve) as well as the expectation of changes in future floating rates. As expectations of future floating rates change, the market value of interest rate swaps changes. Based on the daily market value of those interest rate swaps and interest rate swap forward contracts, our counterparties may request additional margin collateral or we may request additional collateral from our counterparties to ensure that an appropriate margin account balance is maintained at all times through the maturity of the contracts. At March 31, 2007, the unrealized gain on interest rate swap and cap contracts was \$7.7 million due to an increase in prevailing market interest rates.

As of March 31, 2007, we had engaged in credit default swaps, or CDS, which are accounted for as derivatives. CDS are derivative securities that attempt to replicate the credit risk involved with owning a particular unrelated third party security, which we refer to as a reference obligation. We enter into CDS on two types of securities: RMBS and CMBS. Investing in assets through CDS subjects us to additional risks. When we enter into a CDS with respect to an asset, we do not have any legal or beneficial interest in the reference obligation but have only a contractual relationship with the counterparty, typically a broker-dealer or other financial institution, and do not have the benefit of any collateral or other security or remedies that would be available to holders of the reference obligation or the right to receive information regarding the underlying obligors or issuers of the reference obligation. In addition, in the event of insolvency of a CDS counterparty, we would be treated as a general creditor of the counterparty to the extent the counterparty does not post collateral and, therefore, we may be subject to significant counterparty credit risk. As of March 31, 2007, we were party to CDS with

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four counterparties. CDS are relatively new instruments, the terms of which may contain ambiguous provisions that are subject to interpretation, with consequences that could be adverse to us.

We can be the seller or the buyer of protection, currently, across all our exposures we are the seller of the protection. The seller of protection through CDS is exposed to those risks associated with owning the underlying reference obligation. The seller, however, does not receive periodic interest payments, but instead it receives periodic premium payments for assuming the credit risk of the reference obligation. These risks are called credit events and generally consist of failure to pay principal, failure to pay interest, write-downs, implied write-downs and distressed ratings downgrades of the reference obligation.

For some CDS, upon the occurrence of a credit event with respect to a reference obligation, the buyer of protection may have the option to deliver the reference obligation to the seller of protection in part or in whole at par or to elect cash settlement. In this event, should the buyer of protection elect cash settlement for a credit event that has occurred, it will trigger a payment, the amount of which is based on the proportional amount of failure or write-down. In the case of a distressed ratings downgrade, the buyer of protection must deliver the reference obligation to the seller of protection, and there is no cash settlement option. In most cases, however, the CDS is a PAUG (pay as you go) CDS, in which case, at the point a write-down or an interest shortfall occurs, the protection seller pays the protection buyer a cash amount, and the contract remains outstanding until such time as the reference obligation has a factor of zero. In most of these instances, it will create a loss for the protection seller, which is generally us.

As of March 31, 2007, we were a party to 14 credit default swaps with maturities ranging from June 2035 to March 2049 with a notional par amount of \$160.0 million. At March 31, 2007, the fair value of our net liability relating to credit default swap contracts was \$5.7 million, which represented a decrease of \$9.0 million in fair value from December 31, 2006 primarily as a result of an increase in the credit spreads of the CDS.

As of March 31, 2007, we had engaged in currency swaps as a means of mitigating our currency risk under one of our real estate loans that was denominated in Canadian dollars and one of our other investments that was denominated in British Pounds. As of March 31, 2007, we were a party to one currency swap with a maturity of July 2021 with a notional par amount of Can\$50.0 million and one other currency swap with a maturity of January 2014 with a notional par amount of £10.0 million. The current market value of currency swaps is heavily dependent on the current currency exchange rate and the expectation of changes in future currency exchange rates. As expectations of future currency exchange rates change, the market value of currency swaps changes. Based on the daily market value of those currency swaps, our counterparties may request additional margin collateral or we may request additional collateral from our counterparties to ensure that an appropriate margin account balance is maintained at all times through the maturity of the contracts. At March 31, 2007, the net fair value of our derivative asset relating to currency swap contracts was \$0.3 million as a result of a marginal weakening of the United States dollar versus the Canadian dollar and the British pound.

Liabilities

We have entered into repurchase agreements to finance some of our purchases of available for sale securities and real estate loans. These agreements are secured by our available for sale securities and real estate loans and bear interest rates that have historically moved in close relationship to LIBOR. As of March 31, 2007, we had established numerous borrowing arrangements with various investment banking firms and other lenders. As of March 31, 2007, we were utilizing 12 of those arrangements.

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At March 31, 2007, we had outstanding obligations under repurchase agreements with twelve counterparties totaling approximately \$2,114.7 million with weighted average current borrowing rates of 5.50%, all of which have maturities of between five and 75 days. We intend to seek to renew these repurchase agreements as they mature under the then-applicable borrowing terms of the counterparties to the repurchase agreements. At March 31, 2007, the repurchase agreements were secured by available for sale securities and real estate loans and cash with an estimated fair value of approximately \$2,193.3 million and had weighted average maturities of 37 days. The net amount at risk, defined as fair value of the collateral, including restricted cash, minus repurchase agreement liabilities and accrued interest expense, with all counterparties was approximately \$103.3 million at March 31, 2007. One of the repurchase agreements is a \$275.0 million master repurchase agreement with Wachovia Bank that has a two year term, expiring in August 2007, with a one year renewal option. The Wachovia Bank master repurchase agreement provides for the purchase, sale and repurchase of commercial and residential mortgage loans, commercial mezzanine loans, B Notes, participation interests in the foregoing, commercial mortgage-backed securities and other mutually agreed upon collateral and bears interest at varying rates over LIBOR based upon the type of asset included in the repurchase obligation.

Stockholders Equity

Stockholders equity at March 31, 2007 was approximately \$520.9 million and included \$17.5 million of net unrealized holdings losses on securities available for sale and \$4.4 million of net unrealized and realized gains on interest rate agreements accounted for as cash flow hedges presented as a component of accumulated other comprehensive income (loss).

Results of Operations For the Three Months Ended March 31, 2007 compared to the Three Months Ended March 31, 2006

Summary

Our net income for the three months ended March 31, 2007 was \$7.5 million or \$0.30 per weighted average basic and diluted share outstanding, compared with \$15.4 million or \$0.88 per weighted average basic and diluted share outstanding for the three months ended March 31, 2006. Net income decreased by \$7.9 million, or 51.3%, from the first quarter 2006 to the first quarter 2007, while net income per weighted average basic and diluted share outstanding decreased by \$0.58 or 65.9%, from the first quarter 2006 to the first quarter 2007 as the weighted average number of shares of our common stock outstanding increased from 17,495,082 for the first quarter 2006 to 25,043,565 for the first quarter 2007.

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The following table sets forth information regarding our revenues:

	Three Months Ended		Variance	
	2007	2006	Amount	%
	March 31,			
	(in thousands)			
Revenues				
Interest income:				
Commercial MBS	\$ 9,789	\$ 4,460	\$ 5,329	119.5%
Residential MBS Non Agency MBS	9,450	10,827	(1,377)	(12.7)
Agency ARMS	30,003	21,456	8,547	39.8
ABS	993	1,037	(44)	(4.2)
Underwriting costs	(31)	(40)	9	2.3
Real estate loans	4,325	2,611	1,714	65.6
Other interest and dividend income	2,700	727	1,973	271.4
Total interest and dividend income	57,229	41,078	16,151	39.3
Rental income, net	538		538	100.0
Total revenues	\$ 57,767	\$ 41,078	\$ 16,689	40.6

Interest income for the three months ended March 31, 2007 with respect to CMBS, Agency ARMS and real estate loans increased \$5.3 million, or 119.5%, \$8.6 million, or 39.8%, and \$1.7 million, or 65.6%, respectively, over interest income for the same period in 2006 because we had more investments in those asset classes during the first quarter of 2007. For the three months ended March 31, 2007, we also had income of \$0.5 million relating to income from our commercial property investments, which were made in 2007.

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The following table sets forth information regarding our total expenses:

	Three Months Ended		Variance	
	2007	2006	Amount	%
	March 31,			
	(in thousands)			
Expenses				
Interest expense:				
Repurchase agreements	\$ 32,778	\$ 25,355	\$ 7,423	29.3%
Repurchase agreements and notes, related party	2,121	600	1,521	253.5
Interest rate swaps	(2,866)	(581)	(2,285)	(393.3)
CDO notes	6,830	2,901	3,929	135.4
Deferred financing costs	621	484	137	28.3
Other	651	92	559	607.6
Total interest expense	40,135	28,851	11,284	39.1
Management fees, related party	2,353	1,677	676	40.3
Professional fees	782	761	21	2.7
Depreciation and amortization	311		311	100.0
Incentive fees	124		124	100.0
Insurance expense	82	91	(9)	(9.9)
Directors fees	162	144	18	12.5
Public company expense	71		71	100.0
Other expenses	231	92	139	151.1
Total expenses	\$ 44,251	\$ 31,616	\$ 12,635	40.0

Interest expense relating to repurchase agreements and notes, including with related parties, for the three months ended March 31, 2007 increased \$8.9 million, or 34.5%, over the same period in 2006 because we financed a larger investment portfolio in the first quarter of 2007 and interest rates in the first quarter of 2007 were higher than in the first quarter of 2006. Interest expense relating to CDO Notes for the three months ended March 31, 2007 increased \$3.9 million, or 135.4%, over the same period in 2006 as a result of added interest expense from our second CDO financing, which closed in January 2007, and because interest rates were higher in the first quarter of 2007 than in the first quarter of 2006. Interest income from interest rate swaps for the three months ended March 31, 2007 increased \$2.3 million, or 393.3%, over the same period in 2006 because interest rates in the 2007 quarter were higher than in the 2006 quarter and because we had a higher notional amount of interest rate swaps in place in the 2007 quarter.

Expenses for the first quarter of 2007 also included base management fees of approximately \$2.1 million and amortization of approximately \$0.3 million related to restricted stock and options granted to our Manager. Expenses for the first quarter of 2006 also included base management fees of approximately \$1.5 million and amortization of approximately \$0.2 million related to restricted stock and options granted to our manager. Management fee expenses increased primarily due to the increase in stockholders' equity in late 2006 as a result of our initial public offering.

Our Manager has waived its right to request reimbursement from us of third-party expenses that it incurs through June 30, 2007, which amount otherwise would have been required to be reimbursed. The management agreement with Hyperion Brookfield Crystal River, which was negotiated before our business model was implemented, provides that we will

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reimburse our Manager for certain third party expenses that it incurs on our behalf, including rent and utilities. Hyperion Brookfield incurs such costs and did not allocate any such expenses to our Manager in 2005 or 2006 as our Manager's use of such services was deemed to be immaterial. Hyperion Brookfield currently is determining the amount of such rent and utility costs that will be allocated to our Manager commencing July 1, 2007 and we will be responsible for reimbursing such costs allocable to our operations absent any further waiver of reimbursement by our Manager. There are no contractual limitations on our obligation to reimburse our Manager for third party expenses and our Manager may incur such expenses consistent with the grant of authority provided to it pursuant to the management agreement without any additional approval of our board of directors being required. In addition, our Manager may defer our reimbursement obligation from any quarter to a future period; provided, however, that we will record any necessary accrual for any such reimbursement obligations when required by GAAP and our Manager has advised us that it will promptly invoice us for such reimbursements consistent with sound financial accounting policies.

Other Revenues (Expenses)

Other expenses for 2007 totaled approximately \$6.0 million, compared with other revenues of \$6.0 million for 2006, a decrease of \$12.0 million or 200.0%. Other expenses for 2007 consisted primarily of \$8.5 million of realized and unrealized loss on derivatives and a \$0.6 million loss on impairment of securities available for sale, which was offset in part by \$1.6 million of realized net gain on the sale of securities available for sale and real estate loans, \$0.8 million of income from equity investments and \$0.5 million of foreign currency exchange gain. Other revenues for 2006 totaled approximately \$6.0 million, which consisted primarily of \$7.9 million of realized and unrealized gains on derivatives, which was offset in part by \$0.6 million of realized net losses on the sale of securities available for sale and \$1.3 million of losses on impairment of securities available for sale.

Income Tax Expense

We have made an election to be taxed as a REIT under Section 856(c) of the Internal Revenue Code of 1986, as amended, commencing with the tax year ended December 31, 2005. As a REIT, we generally are not subject to federal income tax. To maintain qualification as a REIT, we must distribute at least 90% of our REIT taxable income to our shareholders and meet certain other requirements. If we fail to qualify as a REIT in any taxable year, we will be subject to federal income tax on our taxable income at regular corporate rates. We may also be subject to certain state and local taxes on our income and property. Under certain circumstances, federal income and excise taxes may be due on our undistributed taxable income.

At March 31, 2007 and 2006, we were in compliance with all REIT requirements and, accordingly, have not provided for income tax expense on our REIT taxable income for the three months ended March 31, 2007 or for the three months ended March 31, 2006. We also have a taxable REIT subsidiary that is subject to tax at regular corporate rates. During the three months ended March 31, 2007 and the three months ended March 31, 2006, we recorded \$0.3 million and \$0, respectively, of current income tax expense and \$0.8 million and \$0, respectively, of deferred tax benefit, in each case, that was attributable to our taxable REIT subsidiary. The deferred tax benefit is attributable to the mark to market adjustments for foreign currency swaps held in the TRS. Our total income tax benefit for the three months ended March 31, 2007 of \$0.5 million is included in the other caption in other revenues (expenses).

Liquidity and Capital Resources

Capital is required to fund our investment activities and operating expenses. We believe we currently have sufficient access to capital resources and will continue to use a significant

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amount of our available capital resources to fund our existing business plan. Our capital resources include cash on hand, cash flow from operations, principal and interest payments received from investments, borrowings under reverse repurchase agreements, CDOs, junior subordinated debenture issuances, and proceeds from stock offerings.

We held cash and cash equivalents of approximately \$42.6 million at March 31, 2007, which excludes restricted cash of approximately \$76.4 million that is used to collateralize certain of our repurchase facilities and certain other obligations.

Our operating activities provided net cash of approximately \$7.9 million for the three months ended March 31, 2007 primarily as a result of net income of \$7.5 million, non-cash unrealized loss on derivatives of \$8.6 million, change in deferred income tax of \$0.8 million, non-cash impairment charges relating to available for sale securities of \$0.6 million, and decreases in interest receivable of \$2.7 million, offset in part by non-cash accretion of discount on assets of \$3.2 million, realized net gain on sale of available for sale securities of \$1.6 million, payments on settlement of derivatives of \$0.5 million and a net decrease in accounts payable and accrued liabilities, due to Manager and interest payable of approximately \$8.2 million.

Our operating activities provided net cash of approximately \$8.5 million for the three months ended March 31, 2006 primarily as a result of net income of \$15.4 million, non-cash impairment charges relating to available for sale securities of \$1.3 million, and a net increase in accounts payable and accrued liabilities, due to Manager and interest payable of approximately \$3.0 million, offset in part by non-cash unrealized gains on derivatives of \$7.6 million, non-cash accretion of discount on assets of \$2.0 million and an increase in interest receivable of \$2.8 million.

Our investing activities provided net cash of \$186.9 million for the three months ended March 31, 2007 primarily from the sale of securities available for sale of \$512.2 million and principal repayments from available for sale securities totaling \$124.7 million, which was partially offset by the purchase of securities available for sale of \$148.7 million, the payment of \$234.7 million relating to the acquisition of commercial real estate, the funding of real estate loans of \$14.9 million, the funding of other investments totaling \$35.0 million and the funding of restricted cash for future security purchases relating to CDO II of \$16.5 million.

Our investing activities used net cash of \$292.8 million for the three months ended March 31, 2006 primarily from the purchase of securities available for sale of \$595.5 million and the funding or purchase of real estate loans and other investments totaling \$6.9 million, which was partially offset by receipt of principal payments on securities available for sale and real estate loans of approximately \$111.7 million and \$198.3 million of proceeds from the sale of securities available for sale and the repayment of real estate loans.

Our financing activities used net cash of \$191.2 million for the three months ended March 31, 2007 primarily from the net repayment of borrowings under repurchase agreements, including with related parties, of \$753.7 million and payments on the settlement of derivatives of \$5.5 million, which was partially offset by the issuance of CDO notes in the amount of \$325.0 million, proceeds from a mortgage note payable of \$198.5 million, proceeds from a trust preferred offering of \$50.0 million and proceeds from the settlement of derivatives of \$1.4 million.

Our financing activities provided net cash of \$284.8 million for the three months ended March 31, 2006 primarily from the net proceeds from borrowings under repurchase agreements, including with related parties, of \$390.1 million, partially offset by principal repayments on CDOs of \$16.3 million, repayment of a note payable to a related party of \$35.0 million and net deposits of \$52.8 million of restricted cash used to collateralize certain financings.

Our source of funds as of March 31, 2007, excluding our March 2005 and August 2006 common stock offerings and our March 2007 trust preferred offering, consisted of net proceeds

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from repurchase agreements totaling approximately \$2,114.7 million with a weighted average current borrowing rate of 5.50%, which we used to finance the acquisition of securities available for sale, and proceeds from a mortgage payable used to finance a portion of the purchase price for commercial real estate. We expect to continue to borrow funds in the form of repurchase agreements. As of the date of this report, we have established 20 borrowing arrangements with various investment banking firms and other lenders, 12 of which were in use on March 31, 2007. Increases in short-term interest rates could negatively affect the valuation of our mortgage-related assets, which could limit our borrowing ability or cause our lenders to initiate margin calls. Amounts due upon maturity of our repurchase agreements will be funded primarily through the rollover/reissuance of repurchase agreements and monthly principal and interest payments received on our mortgage-backed securities.

For our short-term (one year or less) and long-term liquidity, which includes investing and compliance with collateralization requirements under our repurchase agreements (if the pledged collateral decreases in value or in the event of margin calls created by prepayments of the pledged collateral), we also rely on the cash flow from operations, primarily monthly principal and interest payments to be received on our mortgage-backed securities, cash flow from the sale of securities, rental income from our commercial real estate investments as well as any primary securities offerings authorized by our board of directors.

Based on our current portfolio, leverage rate and available borrowing arrangements, including our \$275.0 million master repurchase facility with Wachovia Bank, we believe that the net proceeds of our initial public offering, which closed in August 2006, and our first trust preferred offering, which closed in March 2007, together with existing equity capital, combined with the cash flow from operations and the utilization of borrowings, will be sufficient to enable us to meet anticipated short-term (one year or less) liquidity requirements such as to fund our investment activities, pay fees under our management agreement, fund our distributions to stockholders and pay general corporate expenses. However, an increase in prepayment rates substantially above our expectations could cause a temporary liquidity shortfall due to the timing of the necessary margin calls on the financing arrangements and the actual receipt of the cash related to principal paydowns. If our cash resources are at any time insufficient to satisfy our liquidity requirements, we may have to sell debt or additional equity securities. If required, the sale of MBS or real estate loans at prices lower than their carrying value would result in losses and reduced income. Although we have achieved a leverage rate within our targeted leverage range as of March 31, 2007, we have additional capacity to leverage our equity further should the need for additional short-term (one year or less) liquidity arise.

Our ability to meet our long-term (greater than one year) liquidity and capital resource requirements in excess of our borrowing capacity under our \$275.0 million master repurchase facility with Wachovia Bank will be subject to obtaining additional debt financing and equity capital. We may increase our capital resources by making public offerings of equity securities, possibly including classes of preferred stock, common stock, commercial paper, medium-term notes, CDOs, collateralized mortgage obligations and senior or subordinated notes. Such financing will depend on market conditions for capital raises and for the investment of any proceeds. If we are unable to renew, replace or expand our sources of financing on substantially similar terms, it may have an adverse effect on our business and results of operations. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common stock.

We generally seek to borrow between four and eight times the amount of our equity. At March 31, 2007, our total debt was approximately \$2.9 billion, which represented a leverage ratio of approximately 5.5 times.

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In March 2007, our unconsolidated statutory trust, Crystal River Preferred Trust I, issued \$50.0 million of trust preferred securities to a third party investor. The trust preferred securities have a 30-year term, maturing in April 2037, are redeemable at par on or after April 2012 and pay interest at a fixed rate of 7.68% for the first five years ending April 2012, and thereafter, at a floating rate of three month LIBOR plus 2.75%.

Off-Balance Sheet Arrangements

As of March 31, 2007, other than our investment in BREF One, LLC, we did not maintain any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, or special-purpose or variable interest entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of March 31, 2007, we had outstanding commitments to fund real estate construction loans of \$24.1 million, and as of such date, advances of \$22.4 million had been made under these commitments. As of March 31, 2007, we had outstanding commitments to fund an investment in a private equity fund totaling \$3.9 million.

Contractual Obligations and Commitments

As of March 15, 2005, we had entered into a management agreement with Hyperion Brookfield Crystal River. Hyperion Brookfield Crystal River is entitled to receive a base management fee, incentive compensation, reimbursement of certain expenses and, in certain circumstances, a termination fee, all as described in the management agreement. Such fees and expenses do not have fixed and determinable payments. The base management fee is payable monthly in arrears in an amount equal to 1/12 of our equity (as defined in the management agreement) times 1.50%. Hyperion Brookfield Crystal River uses the proceeds from its management fee in part to pay compensation to its officers and employees who, notwithstanding that certain of them also are our officers, receive no cash compensation directly from us. Hyperion Brookfield Crystal River will receive quarterly incentive compensation in an amount equal to the product of: (a) 25% of the dollar amount by which (i) our quarterly net income per share (determined in accordance with the Management Agreement, which principally excludes the effect of non-cash stock compensation expenses and the unrealized change in derivatives) based on the weighted average number of common shares outstanding for the quarter exceeds (ii) an amount equal to (A) the weighted average of the price per share of the common shares in the March 2005 private offering and the prices per common shares in any subsequent offerings by us (including our initial public offering that closed in August 2006), in each case at the time of issuance thereof, multiplied by (B) the greater of (1) 2.4375% and (2) 0.50% plus one-fourth of the Ten Year Treasury Rate for such quarter, multiplied by (b) the weighted average number of shares of common stock outstanding during the quarter; provided, that the foregoing calculation of incentive compensation shall be adjusted to exclude one-time events pursuant to changes in GAAP, as well as non-cash charges after discussion between Hyperion Brookfield Crystal River and our independent directors and approval by a majority of our independent directors in the case of non-cash charges. In accordance with the management agreement, our Manager and the independent members of our board of directors have agreed to adjust the calculation of the Manager's incentive fee to exclude non-cash adjustments required by SFAS 133 relating to the valuation of interest rate swaps, currency swaps and credit default swaps and to exclude unrealized foreign currency translation adjustments required by SFAS 52. See note 11 to our consolidated financial statements included elsewhere herein.

As of March 31, 2007, we had outstanding commitments to fund real estate construction loans of \$24.1 million, and as of such date, advances of \$22.4 million had been made under these commitments. As of March 31, 2007, we had outstanding commitments to fund an investment in a private equity fund totaling \$3.9 million.

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We purchase and sell securities on a trade date that is prior to the related settlement date. As of March 31, 2007, we owed \$80.5 million for our purchase of securities on or prior to March 31, 2007 that settled after March 31, 2007.

The following table presents certain information regarding our repurchase obligations as of March 31, 2007:

Repurchase Agreement Counterparties	Amount at Risk(1) (in thousands)	Weighted Average Maturity of Repurchase Agreement in Days
Banc of America Securities LLC	\$ 5,276	25
Bear, Stearns & Co. Inc.	2,603	29
Citigroup Global Markets Inc.	8,557	59
Credit Suisse First Boston LLC	6,596	37
Deutsche Bank Securities Inc.	8,489	37
Goldman Sachs	2,166	16
Greenwich Capital Markets, Inc.	8,226	50
Lehman Brothers Inc.	14,812	24
Merrill Lynch, Pierce, Fenner & Smith Incorporated	6,847	38
Morgan Stanley & Co. Incorporated	10,279	32
Trilon International, Inc.	27,923	19
WaMu Capital Corp.	1,501	56
Total	\$ 103,275	

(1) Equal to the fair value of collateral minus repurchase agreement liabilities and accrued interest expense.

The repurchase agreements for our repurchase facilities generally do not include substantive provisions other than those contained in the standard master repurchase agreement as published by the Bond Market Association. As noted below, some of our master repurchase agreements that were in effect as of the date of this report contain negative covenants requiring us to maintain certain levels of net asset value, tangible net worth and available funds and comply with interest coverage ratios, leverage ratios and distribution limitations. One of our master repurchase agreements provides that it may be terminated if, among other things, certain material decreases in net asset value occur, our chief executive officer ceases to be involved in the day-to-day operations of our Manager, we lose our REIT status or our Manager is terminated. Generally, if we violate one of these covenants, the counterparty to the master repurchase agreement has the option to declare an event of default, which would accelerate the repurchase date. If such option is exercised, then all of our obligations would come due, including either purchasing the securities or selling the securities, as the case may be. The counterparty to the master repurchase agreement, if the buyer in such transaction, for example, will be entitled to keep all income paid after the exercise, which will be applied to the aggregate unpaid repurchase price and any other amounts owed by us, and we are required to deliver any purchased securities to the counterparty.

Our master repurchase agreement with Banc of America Securities LLC contains a restrictive covenant that requires our net asset value to be no less than the higher of:

the NAV Floor (defined below) and

50% of our net asset value as of December 31 of the prior year.

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For 2007, the NAV Floor is approximately \$278.0 million. For all future periods, the NAV Floor is equal to the higher of:

the NAV Floor and

50% of our net asset value,

in each case as of December 31 of the prior year.

Our master repurchase agreements with Credit Suisse First Boston, LLC and Credit Suisse First Boston, (Europe) Limited each contain a restrictive covenant that would trigger an event of default if our net asset value declines:

by 30% or more from the highest net asset value in the preceding 12-month period then ending,

by 20% or more from the highest net asset value in the preceding three-month period then ending,

by 15% or more from the highest net asset value in the preceding one-month period then ending, or

by 50% or more from the highest net asset value since the date of the master repurchase agreement

or, if we or our Manager receive redemption notices that will result in an net asset value drop to the foregoing levels or below \$175.0 million.

Our master repurchase agreement with Wachovia Bank, National Association contains the following restrictive covenants:

We may not permit the ratio of the sum of adjusted EBITDA (as defined in the master repurchase agreement) to interest expense to be less than 1.25 to 1.00.

We may not permit our debt to equity ratio to be greater than 10:1.

We may not declare or make any payment on account of, or set apart assets for, a sinking or other analogous fund for the purchase, redemption, defeasance, retirement or other acquisition of any of our equity interests, or make any other distribution in respect thereof, either directly or indirectly, whether in cash or property or in our obligations, except, so long as there is no default, event of default or Margin Deficit that has occurred and is continuing. We may (i) make such payments solely to the extent necessary to preserve our status as a REIT and (ii) make additional payments in an amount equal to 100% of funds from operations. A Margin Deficit occurs when the aggregate market value of all the purchased securities subject to all repurchase transactions in which a party is acting as buyer is less than the buyer's margin amount for all transactions, which is the amount obtained by application of the buyer's margin percentage to the repurchase price. The margin percentage is a percentage agreed to by the buyer and seller or the percentage obtained by dividing the market value of the purchased securities on the purchase date by the purchase price on the purchase date.

Our tangible net worth may not be less than the sum of \$300.0 million plus the proceeds from all subsequent equity issuances, net of investment banking fees, legal fees, accountants' fees, underwriting discounts and commissions and other customary fees and expenses that we actually incur.

We may not permit the amount of our cash and cash equivalents at any time to be less than \$15.0 million, after giving effect to any requested repurchase transaction.

Certain of our repurchase agreements and our revolving credit facility contain financial covenants, including maintaining our REIT status and maintaining a specific net asset value or

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worth. As of March 31, 2007, with respect to one debt obligation, we failed to meet one financial covenant. We obtained a waiver with respect to the financial covenant that was not met. As a result, we were in compliance with or have obtained the necessary waivers with respect to all our financial covenants as of March 31, 2007.

We intend to continue to make regular quarterly distributions of all or substantially all of our REIT taxable income to holders of our common stock. In order to maintain our qualification as a REIT and to avoid corporate-level income tax on the income we distribute to our stockholders, we are required to distribute at least 90% of our REIT taxable income (which includes net short-term capital gains) on an annual basis. This requirement can affect our liquidity and capital resources.

Impact of Inflation

Our operating results depend in part on the difference between the interest income earned on our interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities. Changes in the general level of interest rates prevailing in the economy in response to changes in the rate of inflation or otherwise can affect our income by affecting the spread between our interest-earning assets and interest-bearing liabilities, as well as, among other things, the value of our interest-earning assets. Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations, and other factors beyond our control. We employ the use of correlated hedging strategies to limit the effects of changes in interest rates on our operations, including engaging in interest rate swaps to minimize our exposure to changes in interest rates. There can be no assurance that we will be able to adequately protect against the foregoing risks or that we will ultimately realize an economic benefit from any hedging contract into which we enter. Our financial statements are prepared in accordance with GAAP and our distributions are determined by our board of directors consistent with our obligation to distribute to our stockholders at least 90% of our REIT taxable income on an annual basis in order to maintain our REIT qualification; in each case, our activities and balance sheet are measured with reference to historical cost and or fair market value without considering inflation.

Quantitative and Qualitative Disclosures About Market Risk

The principal objective of our asset/liability management activities is to maximize net interest income, while minimizing levels of interest rate risk. Net interest income and interest expense are subject to the risk of interest rate fluctuations. To mitigate the impact of fluctuations in interest rates, we use interest rate swaps to effectively convert variable rate liabilities to fixed rate liabilities for proper matching with fixed rate assets. Each derivative used as a hedge is matched with an asset or liability with which it has a high correlation. The swap agreements are generally held-to-maturity and we do not use derivative financial instruments for trading purposes. We use interest rate swaps to effectively convert variable rate debt to fixed rate debt for the financed portion of fixed rate assets. The differential to be paid or received on these agreements is recognized as an adjustment to the interest expense related to debt and is recognized on the accrual basis.

As of March 31, 2007, the primary component of our market risk was interest rate risk, as described below. Although we do not seek to avoid risk completely, we do believe the risk can be quantified from historical experience and we seek to actively manage that risk, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

Interest Rate Risk We are subject to interest rate risk in connection with most of our investments and our related debt obligations, which are generally repurchase agreements of

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limited duration that are periodically refinanced at current market rates. We mitigate this risk through utilization of derivative contracts, primarily interest rate swap agreements.

Yield Spread Risk Most of our investments are also subject to yield spread risk. The majority of these securities are fixed rate securities, which are valued based on a market credit spread over the rate payable on fixed rate U.S. Treasuries of like maturity. In other words, their value is dependent on the yield demanded on such securities by the market, as based on their credit relative to U.S. Treasuries. An excessive supply of these securities combined with reduced demand will generally cause the market to require a higher yield on these securities, resulting in the use of a higher or wider spread over the benchmark rate (usually the applicable U.S. Treasury security yield) to value these securities. Under these conditions, the value of our real estate securities portfolio would tend to decrease. Conversely, if the spread used to value these securities were to decrease or tighten, the value of our real estate securities would tend to increase. Such changes in the market value of our real estate securities portfolio may affect our net equity or cash flow either directly through their impact on unrealized gains or losses on available-for-sale securities by diminishing our ability to realize gains on such securities, or indirectly through their impact on our ability to borrow and access capital.

Effect on Net Interest and Dividend Income We fund our investments with short-term borrowings under repurchase agreements. During periods of rising interest rates, the borrowing costs associated with those investments tend to increase while the income earned on such investments could remain substantially unchanged. This results in a narrowing of the net interest spread between the related assets and borrowings and may even result in losses.

On March 31, 2007, we were party to 33 interest rate swap contracts and 3 interest rate cap contracts. The following table summarizes the expiration dates of these contracts and their notional amounts (in thousands):

Expiration Date	Notional Amount
2007	\$ 135,000
2008	666,000
2009	210,000
2010	62,500
2011	30,000
2012	115,000
2013	51,494
2015	54,000
2016	45,000
2017	55,000
2018	240,467
2021	42,933
TOTAL	\$ 1,707,394

Hedging techniques are partly based on assumed levels of prepayments of our fixed-rate and hybrid adjustable-rate RMBS. If prepayments are slower or faster than assumed, the life of the RMBS will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns.

Extension Risk We invest in RMBS, some of which have interest rates that are fixed for the first few years of the loan (typically three, five, seven or 10 years) and thereafter reset periodically on the same basis as adjustable-rate RMBS. We compute the projected weighted

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average life of our RMBS based on assumptions regarding the rate at which the borrowers will prepay the underlying mortgages. In general, when a fixed-rate or hybrid adjustable-rate residential mortgage-backed security is acquired with borrowings, we may, but are not required to, enter into an interest rate swap agreement or other hedging instrument that effectively fixes our borrowing costs for a period close to the anticipated average life of the fixed-rate portion of the related RMBS. This strategy is designed to protect us from rising interest rates because the borrowing costs are fixed for the duration of the fixed-rate portion of the related residential mortgage-backed security.

However, if prepayment rates decrease in a rising interest rate environment, the life of the fixed-rate portion of the related RMBS could extend beyond the term of the swap agreement or other hedging instrument. This could have a negative impact on our results from operations, as borrowing costs would no longer be fixed after the end of the hedging instrument while the income earned on the RMBS would remain fixed. This situation may also cause the market value of our RMBS to decline, with little or no offsetting gain from the related hedging transactions. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur losses.

Hybrid Adjustable-Rate RMBS Interest Rate Cap Risk We also invest in hybrid adjustable-rate RMBS, which are based on mortgages that are typically subject to periodic and lifetime interest rate caps and floors, which limit the amount by which the security's interest yield may change during any given period. However, our borrowing costs pursuant to our repurchase agreements will not be subject to similar restrictions. Therefore, in a period of increasing interest rates, interest rate costs on our borrowings could increase without limitation by caps, while the interest-rate yields on our hybrid adjustable-rate RMBS would effectively be limited by caps. This problem will be magnified to the extent we acquire hybrid adjustable-rate RMBS that are not based on mortgages which are fully indexed. In addition, the underlying mortgages may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. This could result in our receipt of less cash income on our hybrid adjustable-rate RMBS than we need in order to pay the interest cost on our related borrowings. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would harm our financial condition, cash flows and results of operations.

Interest Rate Mismatch Risk We intend to continue to fund a substantial portion of our investments with borrowings that, after the effect of hedging, have interest rates based on indices and repricing terms similar to, but of somewhat shorter maturities than, the interest rate indices and repricing terms of our investments. Thus, we anticipate that in most cases the interest rate indices and repricing terms of our mortgage assets and our funding sources will not be identical, thereby creating an interest rate mismatch between assets and liabilities. Therefore, our cost of funds would likely rise or fall more quickly than would our earnings rate on assets. During periods of changing interest rates, such interest rate mismatches could negatively impact our financial condition, cash flows and results of operations. To mitigate interest rate mismatches, we may utilize hedging strategies discussed above.

Our analysis of risks is based on management's experience, estimates, models and assumptions. These analyses rely on models that utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our management may produce results that differ significantly from the estimates and assumptions used in our models and the projected results shown in this Quarterly Report on Form 10-Q.

Prepayment Risk Prepayments are the full or partial repayment of principal prior to the original term to maturity of a mortgage loan and typically occur due to refinancing of mortgage loans. Prepayment rates for existing RMBS generally increase when prevailing interest rates fall below the market rate existing when the underlying mortgages were

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originated. In addition, prepayment rates on adjustable-rate and hybrid adjustable-rate RMBS generally increase when the difference between long-term and short-term interest rates declines or becomes negative. Prepayments of RMBS could harm our results of operations in several ways. Some adjustable-rate mortgages underlying our adjustable-rate RMBS may bear initial teaser interest rates that are lower than their fully-indexed rates, which refers to the applicable index rates plus a margin. In the event that such an adjustable-rate mortgage is prepaid prior to or soon after the time of adjustment to a fully-indexed rate, the holder of the related RMBS would have held such security while it was less profitable and lost the opportunity to receive interest at the fully-indexed rate over the expected life of the adjustable-rate RMBS. Additionally, we currently own mortgage assets that were purchased at a premium. The prepayment of such assets at a rate faster than anticipated would result in a write-off of any remaining capitalized premium amount and a consequent reduction of our net interest income by such amount. Finally, in the event that we are unable to acquire new mortgage assets to replace the prepaid assets, our financial condition, cash flow and results of operations could be negatively affected.

Effect on Fair Value Another component of interest rate risk is the effect changes in interest rates will have on the market value of our assets. We face the risk that the market value of our assets will increase or decrease at different rates than that of our liabilities, including our hedging instruments. We primarily assess our interest rate risk by estimating the duration of our assets and the duration of our liabilities. Duration essentially measures the market price volatility of financial instruments as interest rates change. We generally calculate duration using various financial models and empirical data. Different models and methodologies can produce different duration numbers for the same securities.

The following interest rate sensitivity analysis is measured using an option-adjusted spread model combined with a proprietary prepayment model. We shock the curve up and down 100 basis points and analyze the change in interest rates, prepayments and cash flows through a Monte Carlo simulation. We then calculate an average price for each scenario, which is used in our risk management analysis.

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The following sensitivity analysis table shows the estimated impact on the fair value of our interest rate-sensitive investments, repurchase agreement liabilities, CDO liabilities and swaps, at March 31, 2007, assuming rates instantaneously fall 100 basis points and rise 100 basis points:

	Interest Rates Fall 100 Basis Points	Unchanged (dollars in thousands)	Interest Rates Rise 100 Basis Points
<i>Mortgage assets and other securities available for sale</i>			
(1)			
Fair value	\$ 2,883,525	\$ 2,823,027	\$ 2,754,446
Change in fair value	\$ 60,498		\$ (68,582)
Change as a percent of fair value	2.14%		(2.43)%
<i>Real estate loans</i>			
Fair value	\$ 262,573	\$ 251,694	\$ 240,278
Change in fair value	\$ 10,879		\$ (11,416)
Change as a percent of fair value	4.32%		(4.54)%
<i>Other investments</i> (2)			
Fair value	\$ 20,838	\$ 20,838	\$ 20,838
Change in fair value	n/m		n/m
Change as a percent of fair value	n/m		n/m
<i>Repurchase agreements</i> (3)			
Fair value	\$ (2,114,734)	\$ (2,114,734)	\$ (2,114,734)
Change in fair value	n/m		n/m
Change as a percent of fair value	n/m		n/m
<i>CDO liabilities</i>			
Fair value	\$ (517,929)	\$ (516,895)	\$ (515,912)
Change in fair value	\$ (1,034)		\$ 983
Change as a percent of fair value	0.20%		(0.19)%
<i>Trust preferred securities</i>			
Fair value	\$ (51,550)	\$ (51,550)	\$ (51,550)
Change in fair value	n/m		n/m
Change as a percent of fair value	n/m		n/m
<i>Designated and undesignated interest rate swaps and caps</i>			
Fair value	\$ (45,128)	\$ 7,653	\$ 58,392
Change in fair value	\$ (52,781)		\$ 50,739
Change as a percent of notional value	(3.28)%		3.16%
<i>Credit default swaps (net)</i>			

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Fair value	\$	(5,915)	\$	(5,714)	\$	(5,526)
Change in fair value	\$	(201)			\$	188
Change as a percent of notional value		(0.13)%				0.12%
<i>Cross currency swap (net)</i>						
Fair value	\$	(856)	\$	325	\$	1,408
Change in fair value	\$	(1,181)			\$	1,083
Change as a percent of notional value		(1.94)%				1.78%

(1) The fair value of other available-for-sale investments that are sensitive to interest rate changes are included.

(2) The fair value of our other investments that are sensitive to interest rate changes are included.

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- (3) The fair value of the repurchase agreements would not change materially due to the short-term nature of these instruments.

n/m = not meaningful

It is important to note that the impact of changing interest rates on fair value can change significantly when interest rates change beyond 100 basis points from current levels. Therefore, the volatility in the fair value of our assets could increase significantly when interest rates change beyond 100 basis points. In addition, other factors affect the fair value of our interest rate-sensitive investments and hedging instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, in the event of changes in actual interest rates, the change in the fair value of our assets would likely differ from that shown above, and such difference might be material and adverse to our stockholders.

Currency Risk We have foreign currency exposure related to one commercial real estate loan that is denominated in Canadian dollars and had a carrying value at March 31, 2007 of \$43.3 million and one other investment that is denominated in British pounds and had a carrying value at March 31, 2007 of \$21.4 million. From time to time, we may make other investments that are denominated in a foreign currency through which we may be subject to foreign currency exchange risk.

Changes in currency rates can adversely affect the fair values and earnings of our non-U.S. holdings. We attempt to mitigate this impact by utilizing currency swaps on our foreign currency-denominated investments or foreign currency forward commitments to hedge the net exposure.

Risk Management

To the extent consistent with maintaining our REIT status, we seek to manage our interest rate risk exposure to protect our portfolio of RMBS and other mortgage securities and related debt against the effects of major interest rate changes. We generally seek to manage our interest rate risk by:

monitoring and adjusting, if necessary, the reset indices and interest rates related to our MBS and our borrowings;

attempting to structure our borrowing agreements to have a range of different maturities, terms, amortizations and interest rate adjustment periods;

using derivatives, financial futures, swaps, options, caps, floors and forward sales, to adjust the interest rate sensitivity of our MBS and our borrowings; and

actively managing, on an aggregate basis, the interest rate indices, interest rate adjustment periods, and gross reset margins of our MBS and the interest rate indices and adjustment periods of our borrowings.

Note on Forward-Looking Statements

Except for historical information contained herein, this quarterly report on Form 10-Q contains 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, which involve certain risks and uncertainties. Forward-looking statements are included with respect to, among other things, our current business plan, business and investment strategy and portfolio management. These forward-looking statements are identified by their use of such terms and phrases as intends, intend, intended, estimate, estimates, expects, expect, expected, project, project

anticipates, anticipated, should, designed to, foreseeable future, believe and believes and similar

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expressions. Our actual results or outcomes may differ materially from those anticipated. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statement was made. We assume no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Important factors that we believe might cause actual results to differ from any results expressed or implied by these forward-looking statements are discussed in the cautionary statements contained in Exhibit 99.1 to this Form 10-Q, which are incorporated herein by reference. In assessing forward-looking statements contained herein, readers are urged to read carefully all cautionary statements contained in this Form 10-Q.

Item 3. *Quantitative and Qualitative Disclosures about Market Risk*

See the discussion of quantitative and qualitative disclosures about market risk in the *Quantitative and Qualitative Disclosures About Market Risk* section of Management's Discussion and Analysis of Financial Condition and Results of Operations above.

Item 4. *Controls and Procedures*

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based closely on the definition of disclosure controls and procedures in Rule 13a-15(e). Notwithstanding the foregoing, no matter how well a control system is designed and operated, it can provide only reasonable, not absolute, assurance that it will detect or uncover failures within our Company to disclose material information otherwise required to be set forth in our periodic reports. Also, we may have investments in certain unconsolidated entities. Because we do not control these entities, our disclosure controls and procedures with respect to such entities are necessarily substantially more limited than those we maintain with respect to our consolidated subsidiaries.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in Internal Controls

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act) that occurred during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II.

OTHER INFORMATION

Item 1. *Legal Proceedings*

None

Item 1A. *Risk Factors*

There have been no material changes to the risk factors previously disclosed in the Annual Report on Form 10-K for the year ended December 31, 2006 filed on March 30, 2007 with the SEC. A copy of those risk factors, updated for March 31, 2007, are attached as Exhibit 99.1 to this Quarterly Report on Form 10-Q.

Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds*

None

Item 3. *Defaults Upon Senior Securities*

None

Item 4. *Submission of Matters to a Vote of Security Holders*

None

Item 5. *Other Information*

None

Item 6. *Exhibits*

- 3.1 Charter of Crystal River Capital, Inc. (filed as Exhibit 3.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2006 (File No. 001-32958) filed on March 30, 2007 and incorporated herein by reference)
- 3.2 Amended and Restated Bylaws of Crystal River Capital, Inc. (filed as Exhibit 3.1 to the Company's Current Report on Form 8-K (File No. 001-32958) filed on May 14, 2007 and incorporated herein by reference)
- 10.1(a)* Agreement of Purchase and Sale, dated as of February 16, 2007, by and among CRZ Phoenix I LLC, BREOF BNK Fannin LP and BREOF BNK Phoenix LLC
- 10.1(b)* Partial Assignment Agreement, dated as of March 19, 2007, by and between CRZ Phoenix I LLC and CRZ Houston I LP
- 10.2*

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Junior Subordinated Indenture, dated as of March 20, 2007, by Crystal River Capital, Inc. and The Bank of New York Trust Company, National Association

- 10.3* Amended and Restated Trust Agreement, dated as of March 20, 2007, among Crystal River Capital, Inc., The Bank of New York Trust Company, National Association, as property trustee, The Bank of New York (Delaware), as Delaware trustee, and certain officers of the Company listed therein as administrative trustees
- 11.1 Statements regarding Computation of Earnings per Share (Data required by Statement of Financial Accounting Standard No. 128, Earnings per Share, is provided in Note 12 to the consolidated financial statements contained in this report)
- 31.1* Certification of Clifford E. Lai, President and Chief Executive Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

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- 31.2* Certification of Craig J. Laurie, Chief Financial Officer and Treasurer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1* Certification of Clifford E. Lai, President and Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2* Certification of Craig J. Laurie, Chief Financial Officer and Treasurer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 99.1* Risk Factors

* Filed herewith.

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SIGNATURES

Pursuant to the requirements 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.

CRYSTAL RIVER CAPITAL, INC.

/s/ Clifford E. Lai

Clifford E. Lai
President and Chief Executive Officer

May 15, 2007
Date

/s/ Craig J. Laurie
Craig J. Laurie
Chief Financial Officer and Treasurer

May 15, 2007
Date

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