Invesco Mortgage Capital Inc.
Form 424B4
June 29, 2009

Table of Contents

Filed Pursuant to Rule 424(b)4
Registration No. 333-151665

8,500,000 Shares

Invesco Mortgage Capital Inc.

Common Stock

Invesco Mortgage Capital Inc. is a newly organized Maryland corporation focused on investing in, financing and managing residential and commercial mortgage-backed securities and mortgage loans. We will seek to invest in residential mortgage-backed securities for which a U.S. Government agency or a federally chartered corporation guarantees payments of principal and interest on the securities. In addition, we expect to invest in residential mortgage-backed securities that are not issued or guaranteed by a U.S. Government agency, commercial mortgage-backed securities and mortgage loans. To the extent available to us, we may seek to finance our investments in these asset classes with financings under the Term Asset-Backed Securities Lending Facility or with private financing sources and, if available, we may also make investments in funds that receive financing under the U.S. Government s Public-Private Investment Program. We will be externally managed and advised by Invesco Institutional (N.A.), Inc., a Delaware corporation and an indirect wholly owned subsidiary of Invesco Ltd., an independent global investment company listed on the New York Stock Exchange (NYSE: IVZ). Invesco Institutional (N.A.), Inc. will draw upon the expertise of Invesco Ltd. s Worldwide Fixed Income investment team of 114 investment professionals operating in six cities, across four countries, with approximately $157 billion in securities under management and Invesco Real Estate s 219 employees operating in 13 cities across eight countries with over $20 billion in private and public real estate assets under management. In addition, our Manager will draw upon the mortgage market insights of WL Ross & Co. LLC, Invesco Ltd. s distressed investment unit.

This is our initial public offering and no public market currently exists for our common stock. We are offering 8,500,000 shares of our common stock as described in this prospectus. We expect the initial public offering price of our common stock to be $20.00 per share. Our common stock has been approved for listing on the New York Stock Exchange, subject to official notice of issuance, under the symbol IVR.

Concurrently with the completion of this offering, we will complete a private placement in which we will sell 75,000 shares of our common stock to Invesco Ltd., through Invesco Institutional (N.A.), Inc., at $20.00 per share and 1,425,000 units of limited partnership interest in our operating partnership to Invesco Ltd., through Invesco Investments (Bermuda) Ltd., a wholly owned subsidiary of Invesco Ltd., at $20.00 per unit.

We intend to elect and qualify to be taxed as a real estate investment trust for U.S. federal income tax purposes, commencing with our taxable year ending December 31, 2009. To assist us in qualifying as a real estate investment trust, stockholders are generally restricted from owning more than 9.8% by value or number of shares, whichever is more restrictive, of our outstanding shares of common or capital stock. Different ownership limits will apply to Invesco Ltd. and its direct and indirect subsidiaries, including but not limited to Invesco Institutional (N.A.), Inc. and Invesco Investments (Bermuda) Ltd. In addition, our charter contains various other restrictions on the ownership and transfer of our common stock, see Description of Capital Stock Restrictions on Ownership and Transfer.

Investing in our common stock involves risks. See Risk Factors beginning on page 22 of this prospectus for a discussion of these risks.

We have no operating history and may not be able to successfully operate our business or generate sufficient revenue to make or sustain distributions to our stockholders.

We have not yet identified any specific investments in our target asset classes.

We may allocate the net proceeds from this offering and the concurrent private placement to investments with which you may not agree.

We are dependent on Invesco Institutional (N.A.), Inc. and its key personnel for our success.

There are conflicts of interest in our relationship with Invesco Institutional (N.A.), Inc. and Invesco Ltd., which could result in decisions that are not in the best interests of our stockholders.

Our failure to qualify as a real estate investment trust would subject us to U.S. federal income tax and potentially increased state and local taxes, which would reduce the amount of cash available for distribution to our stockholders.

Maintenance of our exemption from registration under the Investment Company Act of 1940 imposes limits on our operations.

	Per Share	**Total**
Public offering price	$ 20.00	$ 170,000,000
Underwriting discount[(1)]	$ 1.30	$ 11,050,000
Proceeds to us, before expenses[(1)]	$ 19.70	$ 167,450,000

(1) Of the total underwriting discount, Invesco Ltd. (or one of its affiliates other than us) has agreed to pay $8.5 million and we have agreed to pay $2.55 million.

The underwriters may also purchase up to an additional 1,275,000 shares of our common stock from us at the initial public offering price, less the underwriting discount, within 30 days after the date of this prospectus to cover over-allotments, if any.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The shares will be ready for delivery on or about July 1, 2009.

Credit Suisse **Morgan Stanley**

Barclays Capital **Keefe, Bruyette & Woods** **Stifel Nicolaus**

Jackson Securities **Siebert Capital Markets** **The Williams Capital Group, L.P.**

The date of this prospectus is June 25, 2009.

TABLE OF CONTENTS

You should rely only on the information contained in this prospectus, any free writing prospectus prepared by us or information to which we have referred you. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus and any free writing prospectus prepared by us is accurate only as of their respective dates or on the date or dates which are specified in these documents. Our business, financial condition, results of operations and prospects may have changed since those dates.

Until July 20, 2009 (25 days after the date of this prospectus), all dealers that effect transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

SUMMARY

This summary highlights some of the information in this prospectus. It does not contain all of the information that you should consider before investing in our common stock. You should read carefully the more detailed information set forth under Risk Factors and the other information included in this prospectus. Except where the context suggests otherwise, the terms company, we, us, and our refer to Invesco Mortgage Capital Inc., a Maryland corporation, together with its consolidated subsidiaries, including IAS Operating Partnership LP, a Delaware limited partnership, which we refer to as our operating partnership; our Manager refers to Invesco Institutional (N.A.), Inc., a Delaware corporation, our external manager; Invesco refers to Invesco Ltd. together with its consolidated subsidiaries (other than us), the indirect parent company of our Manager; Invesco Purchaser collectively refers to Invesco Institutional (N.A.), Inc. and Invesco Investments (Bermuda) Ltd. and OP units refers to units of limited partnership interest in our operating partnership. Unless indicated otherwise, the information in this prospectus assumes (1) the common stock to be sold in this offering is sold at $20.00 per share, (2) a $30 million investment will be made by the Invesco Purchaser in a private placement to be made concurrently with the completion of this offering, and (3) no exercise by the underwriters of their over-allotment option to purchase up to an additional 1,275,000 shares of our common stock.

Our Company

We are a newly-formed Maryland corporation focused on investing in, financing and managing residential and commercial mortgage-backed securities and mortgage loans, which we collectively refer to as our target assets. We will seek to invest in residential mortgage-backed securities, or RMBS, for which a U.S. Government agency such as the Government National Mortgage Association, or Ginnie Mae, or a federally chartered corporation such as the Federal National Mortgage Association, or Fannie Mae, or the Federal Home Loan Mortgage Corporation, or Freddie Mac, guarantees payments of principal and interest on the securities. We refer to these securities as Agency RMBS. We also expect to invest in RMBS that are not issued or guaranteed by a U.S. Government agency, or non-Agency RMBS, commercial mortgage-backed securities, or CMBS, and residential and commercial mortgage loans.

We anticipate financing our Agency RMBS through traditional repurchase agreement financing. In addition, to the extent available to us, we may seek to finance our investments in CMBS and non-Agency RMBS with financings under the Term Asset-Backed Securities Lending Facility, or TALF, or with private financing sources. If available, we may also finance our investments in certain CMBS and non-Agency RMBS by contributing capital to one or more of the legacy securities public-private investment programs, or Legacy Securities PPIFs, that receive financing under the U.S. Government s Public-Private Investment Program, or PPIP, and our investments in certain legacy commercial and residential mortgage loans by contributing capital to one or more legacy loan public-private investment programs, or Legacy Loan PPIFs, that receive such funding or through private financing sources. Legacy Securities PPIFs and Legacy Loan PPIFs, which we refer to collectively as PPIFs, may be established and managed by our Manager or one of its affiliates or by unaffiliated third parties; however, our Manager or its affiliates may only establish a Legacy Securities PPIF if their application to serve as an investment manager of this type of PPIP fund is accepted by the U.S. Treasury. To the extent we pay any fees to our Manager or any of its affiliates in connection with any PPIF, our Manager has agreed to reduce the management fee payable by us under the management agreement (but not below zero) in respect of any equity investment we may decide to make in any PPIF managed by our Manager or any of its affiliates by the amount of the fees payable to our Manager or its affiliates under the PPIF with regard to our equity investment.

We will be externally managed and advised by Invesco Institutional (N.A.), Inc., or our Manager, an SEC-registered investment adviser and indirect wholly owned subsidiary of Invesco Ltd. (NYSE: IVZ), or Invesco. Invesco is a leading independent global investment management company with $348.2 billion in assets under management as of March 31, 2009. Our Manager will draw upon the expertise of Invesco s Worldwide Fixed Income investment team of 114 investment professionals operating in six cities, across four countries, with approximately $157 billion in securities under management and Invesco Real Estate s 219 employees operating in 13 cities across eight countries with over $20 billion in private and public real

Table of Contents

estate assets under management. With over 25 years of experience, Invesco s teams of dedicated professionals have developed exceptional track records across multiple fixed income sectors and asset classes, including structured securities, such as RMBS, asset-backed securities, or ABS, CMBS, and leveraged loan portfolios. In addition, the investment team will draw upon the mortgage market insights of WL Ross & Co. LLC, or WL Ross, Invesco s distressed investment unit and an indirect, wholly owned subsidiary of our Manager.

Our objective is to provide attractive risk adjusted returns to our investors over the long term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by selectively acquiring target assets to construct a diversified investment portfolio designed to produce attractive returns across a variety of market conditions and economic cycles. We intend to construct a diversified investment portfolio by focusing on security selection and the relative value of various sectors within the mortgage market. We intend to finance our Agency RMBS investments primarily through short-term borrowings structured as repurchase agreements. To date, we have signed nine master repurchase agreements with nine financial institutions, and we are in discussions with nine additional financial institutions for repurchase facilities. As described in more detail below, to the extent available to us, we may seek to finance our non-Agency RMBS, CMBS and mortgage loan portfolios with non-recourse term borrowing facilities and equity financing under the TALF or with private financing sources and, if available, we may make investments in funds that receive financing under the PPIP that will be established and managed by our Manager or one of its affiliates if their application to serve as one of the investment managers for the Legacy Securities Program is accepted by the U.S. Treasury.

We will commence operations upon completion of this offering. We intend to elect and qualify to be taxed as a real estate investment trust, or REIT, for U.S. federal income tax purposes, commencing with our taxable year ending December 31, 2009. We generally will not be subject to U.S. federal income taxes on our taxable income to the extent that we annually distribute all of our net taxable income to stockholders and maintain our intended qualification as a REIT. We also intend to operate our business in a manner that will permit us to maintain our exemption from registration under the Investment Company Act of 1940, or the 1940 Act.

Our Manager

We will be externally managed and advised by our Manager. Pursuant to the terms of the management agreement, our Manager will provide us with our management team, including our officers, along with appropriate support personnel. Each of our officers is an employee of Invesco. We do not expect to have any employees. Our Manager is not obligated to dedicate any of its employees exclusively to us, nor is our Manager or its employees obligated to dedicate any specific portion of its or their time to our business. Our Manager is at all times subject to the supervision and oversight of our board of directors and has only such functions and authority as we delegate to it.

Our Manager s Worldwide Fixed Income investment professionals have extensive experience in performing advisory services for funds, other investment vehicles, and other managed and discretionary accounts that focus on investing in Agency and other RMBS as well as CMBS. As of March 31, 2009, our Manager managed approximately $177.0 billion of fixed income and real estate investments, including approximately $18.8 billion of structured securities, consisting of approximately $11.0 billion of Agency RMBS, $3.9 billion of ABS, $2.0 billion of non-Agency RMBS and $1.9 billion of CMBS. We expect that our Manager will continue to manage its existing portfolio and provide management services to its other clients, including affiliates of Invesco. Neither our Manager nor Invesco has previously managed or advised a public REIT or managed RMBS or CMBS on a leveraged basis.

The Invesco Worldwide Fixed Income investment professionals will benefit from the insight and capabilities of Invesco s distressed investment subsidiary, WL Ross, and Invesco s real estate team.

Our Manager will draw upon the professional experience and knowledge of the investment team of its WL Ross subsidiary. Over the last 30 years, WL Ross has sponsored and managed more than $8.0 billion of distressed equity investments. We will benefit from WL Ross expertise in security selection, portfolio management, and portfolio oversight. When combined with our Manager s investment team s experience in fixed income investing, WL Ross s deep and broad asset management skills will allow us to draw upon extensive investment expertise in order to benefit our shareholders.

In addition, WL Ross-sponsored funds have expanded its position to include the mortgage market through its 2007 investment in American Home Mortgage Servicing, Inc., or AHMSI, the largest independent sub-prime mortgage loan servicer in the United States with an approximate $108 billion servicing portfolio and more than 547,000 mortgage loans across 50 states. As a major loan servicer, AHMSI has tremendous insights regarding mortgage market trends, including prepayment speeds, delinquency rates, default and severity information, which we intend to capitalize on when valuing our target assets. Furthermore, WL Ross sponsored funds have made a strategic investment in Assured Guaranty Ltd., or AGL, which provides credit enhancement products on debt securities issued in the public finance, structured finance and mortgage markets.

Additionally, our Manager will be able to draw upon the experience and resources of Invesco s real estate team, comprised of approximately 124 investment professionals on the ground in key investment markets, which has 25 years of direct real estate investing experience. Our Manager s real estate team will provide us with valuable insights, through its research and monitoring capabilities, on investments in residential and commercial properties. With the properties under management having an aggregate market value of approximately $22.8 billion as of March 31, 2009, this team is a leader in the real estate marketplace and will provide us with residential and commercial property valuations and other property based information that will be critical in supporting our Manager s assessment of RMBS and CMBS valuations.

Invesco Aim Advisors, Inc., or Invesco Aim Advisors, an affiliate of our Manager, will serve as our sub adviser pursuant to an agreement between our Manager and Invesco Aim Advisors. Invesco Aim Advisors will provide input on overall trends in short-term financing markets and make specific recommendations regarding financing of our Agency RMBS. We do not expect our Manager to provide these services to us directly. The fees charged by Invesco Aim Advisors shall be paid by our Manager and shall not constitute a reimbursable expense by our Manager under the management agreement. We expect that the fees charged by Invesco Aim Advisors to our Manager will be substantially similar to the fees Invesco Aim Advisors charges to its other clients for similar services.

We also expect to benefit from our Manager s portfolio management, finance and administration functions, which address legal, compliance, investor relations and operational matters, trade allocation and execution, securities valuation, risk management and information technologies in connection with the performance of its duties.

Concurrently with the completion of this offering, we will complete a private placement in which we will sell 75,000 shares of our common stock to Invesco, through our Manager, at $20.00 per share and 1,425,000 OP units to Invesco, through Invesco Investments (Bermuda) Ltd., at $20.00 per unit. Upon completion of this offering and the concurrent private placement, Invesco, through our Manager, will beneficially own 0.87% of our outstanding common stock (or 0.76% if the underwriters fully exercise their option to purchase additional shares). Assuming that all OP units are redeemed for an equivalent number of shares of our common stock, Invesco, through the Invesco Purchaser, would beneficially own 15% of our outstanding common stock upon completion of this offering and the concurrent private placement (or 13.3% if the underwriters fully exercise their option to purchase additional shares). The Invesco Purchaser will agree that, for a period of one year after the date of this prospectus, it will not, without the prior written consent of Credit Suisse Securities (USA) LLC and Morgan Stanley & Co. Incorporated, dispose of or hedge any of the shares of our common stock or OP units that it purchases in the concurrent private placement, subject to certain exceptions and extension in certain circumstances as described elsewhere in this prospectus.

About Invesco

Invesco is one of the largest independent global investment management firms with offices worldwide. As of March 31, 2009, Invesco had 5,122 employees, the majority of whom were located in North America. Invesco operates under the Invesco Aim Advisors, Invesco Trimark, Atlantic Trust, Invesco, Invesco Perpetual, Invesco PowerShares, and WL Ross brands.

Table of Contents

Our Investment Strategy

We will rely on our Manager s expertise in identifying assets within our target assets. Our Manager s investment team has a strong focus on security selection and the relative value of various sectors within the mortgage markets. We expect that the investment team will make investment decisions on our behalf, which will incorporate their views on the economic environment and the outlook for the mortgage markets, including relative valuation, supply and demand trends, the level of interest rates, the shape of the yield curve, prepayment rates, financing and liquidity, commercial and residential real estate prices, delinquencies, default rates, recovery of various sectors and vintage of collateral, subject to maintaining our REIT qualification and our exemption from registration under the 1940 Act.

Our Target Assets

Our target asset classes and the principal assets we expect to acquire in each are as follows:

Asset Classes	**Principal Assets**
Agency RMBS	*Mortgage Pass-Through Certificates.* Single-family residential mortgage pass-through certificates are securities representing interests in pools of mortgage loans secured by residential real property where payments of both interest and principal, plus pre-paid principal, on the securities are made monthly to holders of the securities, in effect passing through monthly payments made by the individual borrowers on the mortgage loans that underlie the securities, net of fees paid to the issuer/guarantor and servicers of the securities. These mortgage pass-through certificates are guaranteed by a U.S. Government agency or federally chartered corporation. *Collateralized Mortgage Obligations.* Collateralized mortgage obligations, or CMOs, are securities which are structured from U.S. Government agency, or federally chartered corporation-backed mortgage pass-through certificates. CMOs receive monthly payments of principal and interest. CMOs divide the cash flows which come from the underlying mortgage pass-through certificates into different classes of securities. CMOs can have different maturities and different weighted average lives than the underlying mortgage pass-through certificates. CMOs can re-distribute the risk characteristics of mortgage pass-through certificates to better satisfy the demands of various investor types. These risk characteristics would include average life variability, prepayments, volatility, floating versus fixed interest rate and payment and interest rate risk.
Non-Agency RMBS	RMBS that are not issued or guaranteed by a U.S. Government agency or federally charted corporation, with an emphasis on securities that when originally issued were rated in the highest rating category by one or more of the nationally recognized statistical rating organizations.
CMBS	Fixed and floating rate commercial mortgage backed securities, with an emphasis on securities that when originally issued were rated in the highest rating category by one or more of the nationally recognized statistical rating

organizations.

Asset Classes	Principal Assets
Residential Mortgage Loans	*Prime Mortgage Loans.* Prime mortgage loans are mortgage loans that conform to U.S. Government agency underwriting guidelines. Jumbo prime mortgage loans are mortgage loans that conform to U.S. Government agency underwriting guidelines except that the mortgage balance exceeds the maximum amount permitted by the guidelines. *Alt-A Mortgage Loans*. Alt-A mortgage loans are mortgage loans made to borrowers whose qualifying mortgage characteristics do not conform to U.S. Government agency underwriting guidelines, but whose borrower characteristics may. Generally, Alt-A loans allow homeowners to qualify for a mortgage loan with reduced or alternate forms of documentation. *Subprime Mortgage Loans.* Subprime mortgage loans are loans that do not conform to U.S. Government agency underwriting guidelines.
Commercial Mortgage Loans	First or second lien loans, subordinate interests in first mortgages, or B-Notes, bridge loans to be used in the acquisition, construction or redevelopment of a property and mezzanine financings.

We initially expect to finance our investments in Agency MBS primarily through short-term borrowings structured as repurchase agreements. To the extent available to us, we may seek to finance our investments in non-Agency RMBS, CMBS and mortgage loan portfolios with non-recourse term borrowing facilities and equity financing under the TALF or with private financing sources and, if available, we may make investments in funds that receive financing under the PPIP.

Our board of directors has adopted a set of investment guidelines that set out our target assets and other criteria to be used by our Manager to evaluate specific assets as well as our overall portfolio composition. Our Manager will make determinations as to the percentage of our assets that will be invested in each of our target assets. Based on prevailing market conditions, our current expectation is that our initial investment portfolio will consist of between 45% to 55% non-Agency RMBS, 10% to 15% CMBS and the balance in Agency RMBS. However, there is no assurance that upon the completion of this offering we will not allocate the proceeds from this offering and concurrent private placement in a different manner among our target assets. Our decisions will depend on prevailing market conditions and may change over time in response to opportunities available in different interest rate, economic and credit environments. As a result, we cannot predict the percentage of our assets that will be invested in any of our target asset classes at any given time. We may change our strategy and policies without a vote of our stockholders. We believe that the diversification of our portfolio of assets, our Manager s expertise among our target assets and flexibility of our strategy, combined with our Manager s and its affiliates expertise, will enable us to achieve attractive risk-adjusted returns under a variety of market conditions and economic cycles.

Investment Guidelines

Our board of directors has adopted the following investment guidelines:

no investment shall be made that would cause us to fail to qualify as a REIT for federal income tax purposes;

no investment shall be made that would cause us to be regulated as an investment company under the 1940 Act;

our investments will be in our target assets; and

until appropriate investments can be identified, our Manager may invest the proceeds of this and any future offerings in interest-bearing, short-term investments, including money market accounts and/or funds, that are consistent with our intention to qualify as a REIT.

Table of Contents

These investment guidelines may be changed from time to time by our board of directors without the approval of our stockholders.

Our Manager has an investment committee, or Investment Committee, comprised of its officers and investment professionals. The Investment Committee will periodically review our investment portfolio and its compliance with our investment policies and procedures, including these investment guidelines, and provide to our board of directors an investment report at the end of each quarter in conjunction with its review of our quarterly results. From time to time, as it deems appropriate or necessary, our board of directors also will review our investment portfolio and its compliance with our investment policies and procedures, including these investment guidelines.

Our Financing Strategy

We intend to employ prudent leverage to increase potential returns to our stockholders and to fund the acquisition of our target assets. Our income will be generated primarily by the net spread between the income we earn on our investments in our target assets and the cost of our financing and hedging activities. Although we are not required to maintain any particular leverage ratio, the amount of leverage we will deploy for particular investments in our target assets will depend upon our Manager s assessment of a variety of factors, which may include, the anticipated liquidity and price volatility of the assets in our investment portfolio, the gap between the duration of our assets and liabilities including hedges, the availability and cost of financing the assets, our opinion of the creditworthiness of our financing counterparties, the health of the U.S. economy and residential and commercial mortgage-related markets, our outlook for the level, slope, and volatility of interest rates, the credit quality of the loans we acquire, the collateral underlying our Agency RMBS, non-Agency RMBS and CMBS, and our outlook for asset spreads relative to the London Interbank Offered Rate, or LIBOR, curve.

We expect, initially, that we may deploy, on a debt-to-equity basis, up to seven to eight times leverage on our Agency RMBS assets. In addition, we do not expect under current market conditions to deploy leverage on our non-Agency RMBS, CMBS and mortgage loan assets, except in conjunction with financings that may be available to us under programs established by the U.S. Government. For these asset classes, we expect to use approximately five to six times leverage. We consider these initial leverage ratios to be prudent for these asset classes.

Subject to maintaining our qualification as a REIT for U.S. federal income tax purposes, we expect to use a number of sources to finance our investments. Initially, we expect our primary financing sources to include repurchase agreements and, to the extent available to us, financings under programs established by the U.S. Government such as the TALF or private financing sources, as described in more detail below, and, if available, we may make investments in funds that receive financing under the PPIP.

Repurchase Agreements

Repurchase agreements are financings pursuant to which we will sell our target assets to the repurchase agreement counterparty, the buyer, for an agreed upon price with the obligation to repurchase these assets from the buyer at a future date and at a price higher than the original purchase price. The amount of financing we will receive under a repurchase agreement is limited to a specified percentage of the estimated market value of the assets we sell to the buyer. The difference between the sale price and repurchase price is the cost, or interest expense, of financing under a repurchase agreement. Under repurchase agreement financing arrangements, the buyer, or lender, could require us to provide additional cash collateral, or a margin call, to re-establish the ratio of value of the collateral to the amount of borrowing.

The Term Asset-Backed Securities Lending Facility

On November 25, 2008, the U.S. Treasury and the Federal Reserve announced the creation of the TALF. Under the TALF, The Federal Reserve Bank of New York, or the FRBNY, provides non-recourse loans to borrowers to fund their purchase of eligible assets, which initially included certain ABS, but not RMBS or CMBS. On March 23, 2009, the U.S. Treasury announced preliminary plans to expand the TALF to include non-Agency RMBS and CMBS. On May 1, 2009, the Federal Reserve provided more of the details as to how TALF is to be expanded to CMBS and explained that beginning on June 16, 2009, up to $100 billion of TALF loans will be available to finance purchases of CMBS created on or after January 1, 2009. Additionally, on May 19, 2009, the Federal Reserve announced that certain high quality legacy CMBS, including CMBS issued before January 1, 2009, would become eligible collateral under the TALF starting in July 2009. We believe that the expansion of the TALF to include highly rated CMBS will provide us with attractively priced non-recourse term borrowings that we could use to purchase newly created and legacy CMBS that are eligible for funding under this program. Many legacy CMBS have had their ratings downgraded by at least one rating agency (or have been put on notice as being likely to be downgraded in the near future) as property values have declined during the current recession because a large amount of legacy CMBS are backed by whole loans that were originated during a period of time when property values were relatively high and economic fundamentals were relatively strong. These downgradings significantly reduce the quantity of legacy CMBS that are TALF eligible. Accordingly, unless the criteria for legacy CMBS eligibility change, we expect most of our TALF eligible CMBS investments will be in newly issued CMBS. To date, the TALF has also not yet been expanded to cover non-Agency RMBS. We believe that once so expanded, the TALF may provide us with attractively priced non-recourse term borrowing facilities that we can use to purchase non-Agency RMBS. However, there can be no assurance that the TALF will be expanded to include this asset class and, if so expanded, that we will be able to utilize it successfully or at all.

The Public-Private Investment Program

On March 23, 2009, the U.S. Treasury, in conjunction with the Federal Deposit Insurance Corporation, or the FDIC, and the Federal Reserve, announced the creation of the PPIP. The PPIP is designed to encourage the transfer of certain illiquid legacy real estate-related assets off of the balance sheets of financial institutions, restarting the market for these assets and supporting the flow of credit and other capital into the broader economy. PPIP funds under the Legacy Loan Program, or Legacy Loan PPIFs, will be established to purchase troubled loans from insured depository institutions and PPIP funds under the Legacy Securities Program, or Legacy Securities PPIFs, will be established to purchase from financial institutions legacy non-Agency RMBS and newly issued and legacy CMBS that were originally AAA rated. Legacy Loan PPIFs and Legacy Securities PPIFs will have access to equity capital from the U.S. Treasury as well as debt financing provided or guaranteed by the U.S. Government. We anticipate being able to benefit from the financing available under this program primarily as an investor in one or more Legacy Securities PPIFs that will be established and managed by our Manager or one of its affiliates if their application to serve as one of the investment managers for the Legacy Securities Program is accepted by the U.S. Treasury, or in other Legacy Securities PPIFs established and managed by third parties. Our use of these programs and the amount of equity capital we may contribute to take advantage of them could be substantial. We also may be able to benefit from the financing available under the Legacy Loan Program as an investor in one or more Legacy Loan PPIFs that will be established and managed by our Manager or one of its affiliates. However, in light of the announcement by the FDIC that it is postponing the implementation of the Legacy Loan Program, there is no assurance that this program will ever be finalized or adopted in a way in which we would elect to participate or that the final terms will enable us to participate in the PPIP in a manner consistent with our investment strategy.

Risk Management

As part of our risk management strategy, our Manager will actively manage the financing, interest rate, credit risk, prepayment and convexity (the measure of the sensitivity of the duration of a bond to changes in interest rates) risks associated with holding a portfolio of our target assets.

Interest Rate Hedging

Subject to maintaining our qualification as a REIT, we intend to engage in a variety of interest rate management techniques that seek on one hand to mitigate the influence of interest rate changes on the values of some of our assets, and on the other hand help us achieve our risk management objective. We intend to utilize derivative financial instruments, including, among others, puts and calls on securities or indices of securities, interest rate swaps, interest rate caps, interest rate swaptions, exchange-traded derivatives, U.S. Treasury securities and options on U.S. Treasury securities and interest rate floors to hedge all or a portion of the interest rate risk associated with the financing of our investment portfolio. Specifically, we will seek to hedge our exposure to potential interest rate mismatches between the interest we earn on our investments and our borrowing costs caused by fluctuations in short-term interest rates. In utilizing leverage and interest rate hedges, our objectives will be to improve risk-adjusted returns and, where possible, to lock in, on a long-term basis, a favorable spread between the yield on our assets and the cost of our financing. We will rely on our Manager s expertise to manage these risks on our behalf. We may implement part of our hedging strategy through a domestic taxable REIT subsidiary, or TRS, which will be subject to U.S. federal, state and, if applicable, local income tax.

Market Risk Management

Risk management is an integral component of our strategy to deliver returns to our stockholders. Because we will invest in MBS, investment losses from prepayment, interest rate volatility or other risks can meaningfully reduce or eliminate our distributions to stockholders. In addition, because we will employ financial leverage in funding our portfolio, mismatches in the maturities of our assets and liabilities can create risk in the need to continually renew or otherwise refinance our liabilities. Our net interest margins will be dependent upon a positive spread between the returns on our asset portfolio and our overall cost of funding. To minimize the risks to our portfolio, we will actively employ portfolio-wide and security-specific risk measurement and management processes in our daily operations. Our Manager s risk management tools include software and services licensed or purchased from third parties, in addition to proprietary software and analytical methods developed by Invesco. There can be no guarantee that these tools will protect us from market risks.

Credit Risk

We believe our investment strategy will generally keep our credit losses and financing costs low. However, we retain the risk of potential credit losses on all of the residential and commercial mortgage loans, as well as the loans underlying the non-Agency RMBS and CMBS we hold. We seek to manage this risk through our pre-acquisition due diligence process and through use of non-recourse financing which limits our exposure to credit losses to the specific pool of mortgages that are subject to the non-recourse financing. In addition, with respect to any particular target asset, our Manager s investment team evaluates, among other things, relative valuation, supply and demand trends, shape of yield curves, prepayment rates, delinquency and default rates, recovery of various sectors and vintage of collateral.

Our Competitive Advantages

We believe that our competitive advantages include the following:

Significant Experience of Our Manager

The senior management team of our Manager has a long track record and broad experience in managing residential and commercial mortgage-related assets through a variety of credit and interest rate environments and has demonstrated the ability to generate attractive risk adjusted returns under different market conditions and cycles. As of March 31, 2009, our Manager managed approximately $177.0 billion of fixed income and real estate investments, including $18.8 billion of structured securities, consisting of approximately $11.0 billion of Agency RMBS, $3.9 billion of ABS, $2.0 billion of non-Agency RMBS and $1.9 billion of CMBS. In addition, our Manager will benefit from the insight and capabilities of Invesco s distressed investment subsidiary, WL Ross, and Invesco s real estate team. Our Manager will draw upon the professional experience and knowledge of the investment team of its WL Ross subsidiary and benefit from WL Ross expertise in security selection, portfolio management, and portfolio oversight. Our Manager also will be able to draw upon the experience and resources of Invesco s real estate team, comprised of approximately 124 investment professionals on the ground in key investment markets, which has 25 years of direct real estate investing experience. Our Manager s real estate team will provide us with valuable insights, through its research and monitoring capabilities, on investments in residential and commercial properties. Through our Manager s WL Ross subsidiary and Invesco s real estate team we will also have access to broad and deep teams of experienced investment professionals in real estate and distressed investing. Through these teams, we will have real time access to research and data on the mortgage and real estate industries. Having in-house access to these resources and expertise provides us with a competitive advantage over other companies investing in our target assets who have less internal resources and expertise.

Access to Extensive Repurchase Agreement Financing and Other Strategic Relationships

An affiliate of our Manager and a sub-adviser to us, Invesco Aim Advisors, has been active in the repurchase agreement lending market since 1980 and currently has master repurchase agreements in place with a number of counterparties. At March 31, 2009, Invesco Aim Advisors had provided repurchase agreement financing to these counterparties equal to approximately $20.7 billion.

Invesco Aim Advisors has in place a documented process to mitigate counterparty risk. Our Manager, together with a dedicated team of professionals at Invesco Aim Advisors pursuant to a sub-advisory agreement between our Manager and Invesco Aim Advisors, follows this established process. During these volatile times in which a number of repurchase agreement counterparties have either defaulted or ceased to exist, we feel that it is critical to have controls in place that address this recent disruption in the markets. All repurchase agreement counterparty approval requests must be submitted to the team of nine professionals at Invesco Aim Advisors and undergo a rigorous review and approval process to determine whether the proposed counterparty meets established criteria. This process involves a credit analysis of each prospective counterparty to ensure that it meets Invesco Aim Advisors internal credit risk requirements, a review of the counterparty s audited financial statements, credit ratings and clearing arrangements, and a regulatory background check. In addition, all approved counterparties are monitored on an ongoing basis by Invesco Aim Advisors credit team and, if they deem a credit situation to be deteriorating, they have the ability to restrict or terminate trading with this counterparty. We do not expect to enter into any hedging transactions to mitigate any risks associated with our repurchase agreement counterparties.

Extensive Strategic Relationships and Experience of our Manager and its Affiliates

Our Manager and its affiliates, including Invesco Aim Advisors, maintain extensive long-term relationships with other financial intermediaries, including primary dealers, leading investment banks, brokerage firms, leading mortgage originators and commercial banks. We believe these relationships will enhance our ability to source, finance and hedge investment opportunities and, thus, enable us to grow in various credit and interest rate environments. In addition, we believe the contacts our Manager and its affiliates (including Invesco Aim Advisors) have with numerous investment grade derivative and lending counterparties will assist us in implementing our financing and hedging strategies.

Disciplined Investment Approach

We will seek to maximize our risk-adjusted returns through our Manager s disciplined investment approach, which relies on rigorous quantitative and qualitative analysis. Our Manager will monitor our overall portfolio risk and evaluate the characteristics of our investments in our target assets including, but not limited to, loan balance distribution, geographic concentration, property type, occupancy, periodic and periodic interest rate caps, which limit the amount an interest rate can increase during any given period, or lifetime interest rate caps, weighted-average loan-to-value and weighted-average credit score. In addition, with respect to any particular target asset, our Manager s investment team evaluates, among other things, relative valuation, supply and demand trends, shape of yield curves, prepayment rates, delinquency and default rates recovery of various sectors and vintage of collateral. As a newly organized company with no historical investments, we will build an initial portfolio consisting of currently priced assets and therefore we will likely not be negatively impacted by the recent price declines experienced by many mortgage portfolios. We believe this strategy and our commitment to capital preservation will provide us with a competitive advantage when operating in a variety of market conditions.

Access to Our Manager s Sophisticated Analytical Tools, Infrastructure and Expertise

We will utilize our Manager s proprietary and third-party mortgage-related security and portfolio management tools to seek to generate an attractive net interest margin from our portfolio. We intend to focus on in-depth analysis of the numerous factors that influence our target assets, including: (1) fundamental market and sector review; (2) rigorous cash flow analysis; (3) disciplined security selection; (4) controlled risk exposure; and (5) prudent balance sheet management. We will utilize these tools to guide the hedging strategies developed by our Manager to the extent consistent with satisfying the requirements for qualification as a REIT. In addition, we will use our proprietary technology management platform called QTech^{sm} to monitor investment risk. QTech^{sm} collects and stores real-time market data, and integrates markets performance with portfolio holdings and proprietary risk models to measure the risk positions in portfolios. This measurement system portrays overall portfolio risk and its sources. Through the use of the tools described above, we will analyze factors that affect the rate at which mortgage prepayments occur, including changes in the level of interest rates, directional trends in residential and commercial real estate prices, general economic conditions, the locations of the properties securing the mortgage loans and other social and demographic conditions in order to acquire the target assets that we believe are undervalued. We believe that sophisticated analysis of both macro and micro economic factors will enable us to manage cash flow and distributions while preserving capital.

Our Manager has created and maintains analytical and portfolio management capabilities to aid in security selection and risk management. We intend to capitalize on the market knowledge and ready access to data across our target markets that our Manager and its affiliates obtain through their established platform. We will also benefit from our Manager s comprehensive finance and administrative infrastructure, including its risk management and financial reporting operations, as well as its business development, legal and compliance teams.

Alignment of Invesco and Our Manager s Interests

Concurrently with the completion of this offering, we will complete a private placement in which we will sell 75,000 shares of our common stock to Invesco, through our Manager, at $20.00 per share and 1,425,000 OP units to Invesco, through Invesco Investments (Bermuda) Ltd., at $20.00 per unit. Upon completion of this offering and the concurrent private placement, Invesco, through our Manager, will beneficially own 0.87% of our common stock (or 0.76% if the underwriters fully exercise their option to purchase additional shares). Assuming that all OP units are redeemed for an equivalent number of shares of our common stock, Invesco, through the Invesco Purchaser, would beneficially own 15% of our outstanding common stock upon completion of this offering and the concurrent private placement (or 13.3% if the underwriters fully exercise their option to purchase additional shares). We believe that the significant ownership of our common stock by Invesco, through the Invesco Purchaser, will align Invesco and our Manager s interests with our interests.

Tax Advantages of REIT Qualification

Assuming that we meet, on a continuing basis, various qualification requirements imposed upon REITs by the Internal Revenue Code, we will generally be entitled to a deduction for dividends that we pay and, therefore, will not be subject to U.S. federal corporate income tax on our net income that is distributed currently to our stockholders. This treatment substantially eliminates the double taxation at the corporate and stockholder levels that results generally from investment in a corporation.

Table of Contents

Summary Risk Factors

An investment in shares of our common stock involves various risks. You should consider carefully the risks discussed below and under the heading Risk Factors beginning on page 22 of this prospectus before purchasing our common stock. If any of the following risks occur, our business, financial condition or results of operations could be materially and adversely affected. In that case, the trading price of our common stock could decline, and you may lose some or all of your investment.

- We are dependent on our Manager and its key personnel for our success. In addition, we intend to rely on our financing opportunities relating to our repurchase agreement financing that have been and will be facilitated and/or provided by Invesco Aim Advisors, an affiliate of our Manager.

- Neither Invesco nor our Manager have any experience operating a REIT or managing a portfolio of our target assets on a leveraged basis and we cannot assure you that our Manager s past experience will be sufficient to successfully manage our business as a REIT with such a portfolio.

- There are conflicts of interest in our relationship with our Manager and Invesco, which could result in decisions that are not in the best interests of our stockholders.

- The management agreement with our Manager was not negotiated on an arm s-length basis and may not be as favorable to us as if it had been negotiated with an unaffiliated third party and may be costly and difficult to terminate.

- Our board of directors will approve very broad investment guidelines for our Manager and will not approve each investment and financing decision made by our Manager.

- There can be no assurance that the actions of the U.S. Government, Federal Reserve, U.S. Treasury and other governmental and regulatory bodies for the purpose of stabilizing the financial markets, including the establishment of the TALF and the PPIP, or market response to those actions, will achieve the intended effect, and our business may not benefit from these actions and further government or market developments could adversely impact us.

- We may change any of our strategies, policies or procedures without stockholder consent.

- We have no operating history and may not be able to successfully operate our business or generate sufficient revenue to make or sustain distributions to our stockholders.

- Maintenance of our 1940 Act exemption imposes limits on our operations.

- We expect to use leverage in executing our business strategy, which may adversely affect the return on our assets and may reduce cash available for distribution to our stockholders, as well as increase losses when economic conditions are unfavorable.

- We will depend on repurchase agreement financing to acquire Agency RMBS, and our inability to access this funding for our Agency RMBS could have a material adverse effect on our results of operations, financial condition and business.

- As a result of recent market events, including the contraction among and failure of certain lenders, it may be more difficult for us to secure non-governmental financing.

An increase in our borrowing costs relative to the interest we receive on investments in our target assets may adversely affect our profitability, and our cash available for distribution to our stockholders.

To the extent available to us, we may seek to finance our investments in non-Agency RMBS, CMBS and mortgage loan portfolio with equity and debt financing under U.S. government programs, and our inability to access this financing could have a material adverse effect on our results of operations, financial condition and business.

Hedging against interest rate exposure may adversely affect our earnings, which could reduce our cash available for distribution to our stockholders.

We have not yet identified any specific investments in our target asset classes.

We may allocate the net proceeds from this offering and the concurrent private placement to investments with which you may not agree.

Our investments may be concentrated and will be subject to risk of default.

Continued adverse developments in the residential and commercial mortgage markets, including recent increases in defaults, credit losses and liquidity concerns, could make it difficult for us to borrow money to acquire our target assets on a leveraged basis, on attractive terms or at all, which could adversely affect our profitability.

We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments in our target assets and could also affect the pricing of these securities.

We may acquire non-Agency RMBS collateralized by subprime and Alt-A mortgage loans, which are subject to increased risks.

The mortgage loans that we will acquire, and the mortgage and other loans underlying the non-Agency RMBS and CMBS that we will acquire, are subject to defaults, foreclosure timeline extension, fraud and commercial and residential price depreciation, and unfavorable modification of loan principal amount, interest rate and amortization of principal, which could result in losses to us.

If our Manager overestimates the loss-adjusted yields of our CMBS investments, we may experience losses.

An increase in interest rates may cause a decrease in the volume of certain of our target assets which could adversely affect our ability to acquire target assets that satisfy our investment objectives and to generate income and pay dividends.

Prepayment rates may adversely affect the value of our investment portfolio.

Our failure to qualify as a REIT would subject us to U.S. federal income tax and potentially increased state and local taxes, which would reduce the amount of cash available for distribution to our stockholders.

Complying with REIT requirements may cause us to forego otherwise attractive investment opportunities or financing or hedging strategies.

Our Structure

We were organized as a Maryland corporation on June 5, 2008. We consider Invesco to be our promoter. We will conduct substantially all of our operations through our operating partnership, of which we are the sole general partner. Subject to certain limitations and exceptions, the limited partners of the operating partnership, other than us or our subsidiaries, will have the right to cause the operating partnership to redeem their OP units for cash equal to the market value of an equivalent number of our shares of common stock, or, at our option, we may purchase their OP units by issuing one share of common stock for each OP unit redeemed.

Table of Contents

The following chart shows our structure after giving effect to this offering and the concurrent private placement to the Invesco Purchaser:

(1) Assuming redemption of all OP units owned by the Invesco Investments (Bermuda) Ltd. for the equivalent number of shares of our common stock, Invesco would beneficially own (through the holdings of the Invesco Purchaser) 15% of our common stock and the public would own the remaining 85%.

(2) We expect IAS Asset I LLC to qualify for an exemption from registration under the 1940 Act as an investment company pursuant to Section 3(c)(5)(C) of the 1940 Act. We may in the future organize special purpose subsidiaries that may borrow under the TALF. We anticipate that some of these subsidiaries may be organized to rely on the 1940 Act exemption provided to certain structured financing vehicles by Rule 3a-7. We intend to conduct our operations so that the value of our operating partnership s investment in IAS I LLC, these special purpose subsidiaries, as well as other subsidiaries not relying on Section 3(c)(1) or Section 3(c)(7) of the 1940 Act will at all times, on an unconsolidated basis, exceed 60% of our operating partnership s total assets. See Business Operating and Regulatory Structure 1940 Act Exemption.

Table of Contents

Management Agreement

We will be externally managed and advised by our Manager. We expect to benefit from the personnel, infrastructure, relationships and experience of our Manager to enhance the growth of our business. Each of our officers is an employee of Invesco. We do not expect to have any employees. Our Manager is not obligated to dedicate certain of its personnel exclusively to us, nor is our Manager or its personnel obligated to dedicate any specific portion of its or their time to our business.

We will enter into a management agreement with our Manager effective upon the closing of this offering. Pursuant to the management agreement, our Manager will implement our business strategy and perform certain services for us, subject to oversight by our board of directors. Our Manager will be responsible for, among other duties, (1) performing all of our day-to-day functions, (2) determining investment criteria in conjunction with our board of directors, (3) sourcing, analyzing and executing investments, asset sales and financings, and (4) performing asset management duties. In addition, our Manager has an Investment Committee of our Manager s professionals that will oversee compliance with our investment guidelines, investment portfolio holdings, financing and leveraging strategies.

The initial term of the management agreement will end two years after the closing of this offering, with automatic one-year renewal terms that end on the anniversary of the closing of this offering. Our independent directors will review our Manager s performance annually and, following the initial term, the management agreement may be terminated annually upon the affirmative vote of at least two-thirds of our independent directors based upon: (1) our Manager s unsatisfactory performance that is materially detrimental to us or (2) our determination that the management fees payable to our Manager are not fair, subject to our Manager s right to prevent termination based on unfair fees by accepting a reduction of management fees agreed to by at least two-thirds of our independent directors. We will provide our Manager with 180 days prior notice of such termination. Upon such a termination, we will pay our Manager a termination fee equal to three times the management fee described in the table below. We may also terminate the management agreement with 30 days prior notice from our board of directors, without payment of a termination fee, for cause, as defined in the management agreement. Our Manager may terminate the management agreement if we become required to register as an investment company under the 1940 Act, with such termination deemed to occur immediately before such event, in which case we would not be required to pay a termination fee. Our Manager may also decline to renew the management agreement by providing us with 180 days written notice, in which case we would not be required to pay a termination fee.

Invesco Aim Advisors will serve as our sub-adviser pursuant to an agreement between our Manager and Invesco Aim Advisors. Invesco Aim Advisors will provide input on overall trends in short-term financing markets and make specific recommendations regarding financing of Agency RMBS. We do not expect our Manager to provide these services to us directly. The fees charged by Invesco Aim Advisors shall be paid by our Manager and shall not constitute a reimbursable expense by our Manager under the management agreement.

Table of Contents

The following table summarizes the fees and expense reimbursements that we will pay to our Manager:

Type	Description	Payment
Management fee:	1.50% of our stockholders equity per annum and calculated and payable quarterly in arrears. For purposes of calculating the management fee, our stockholders equity means the sum of the net proceeds from all issuances of our equity securities since inception (allocated on a pro rata daily basis for such issuances during the fiscal quarter of any such issuance), plus our retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount that we pay to repurchase our common stock since inception, and excluding any unrealized gains, losses or other items that do not affect realized net income (regardless of whether such items are included in other comprehensive income or loss, or in net income). This amount will be adjusted to exclude one-time events pursuant to changes in accounting principles generally accepted in the United States, or GAAP, and certain non-cash items after discussions between our Manager and our independent directors and approved by a majority of our independent directors. Our stockholders equity, for purposes of calculating the management fee, could be greater or less than the amount of stockholders equity shown on our financial statements. We will treat outstanding limited partner interests (not held by us) as outstanding shares of capital stock for purposes of calculating the management fee. To the extent we pay any fees to our Manager or any of its affiliates in connection with any PPIF, our Manager has agreed to reduce the management fee payable by us under the management agreement (but not below zero) in respect of any equity investment we may decide to make in any PPIF managed by our Manager or any of its affiliates by the amount of the fees payable to our Manager or its affiliates under the PPIF with regard to our equity investment. However, our Manager s management fee will not be reduced in respect of any equity investment we may decide to make in a Legacy Securities or Legacy Loan PPIF managed by an entity other than our Manager or any of its affiliates.	Quarterly in cash

Expense reimbursement	Reimbursement of operating expenses related to us incurred by our Manager, including certain salary expenses and other expenses relating to legal, accounting, due diligence and other services. Our reimbursement obligation is not subject to any dollar limitation.	Monthly in cash.
Termination fee	Termination fee equal to three times the sum of the average annual management fee earned by our Manager during the prior 24-month period prior to such termination, calculated as of the end of the most recently completed fiscal quarter.	Upon termination of the management agreement by us without cause or by our Manager if we materially breach the management agreement.

Table of Contents

Type	Description	Payment
Incentive plan	Our equity incentive plan includes provisions for grants of restricted common stock and other equity based awards to our directors or officers or any employees of our Manager. We do not expect to grant any awards under our equity incentive plan upon completion of this offering.	

Conflicts of Interest

We are dependent on our Manager for our day-to-day management and do not have any independent officers or employees. Each of our officers and two of our directors, Mr. Armour and Ms. Dunn Kelley, are employees of Invesco. Our management agreement with our Manager was negotiated between related parties and its terms, including fees and other amounts payable, may not be as favorable to us as if it had been negotiated at arm s length with an unaffiliated third party. In addition, the obligations of our Manager and its officers and personnel to engage in other business activities, including for Invesco, may reduce the time our Manager and its officers and personnel spend managing us.

As of March 31, 2009, Invesco had $348.2 billion in managed assets and our Manager managed approximately $177.0 billion of fixed income and real estate investments, including approximately $18.8 billion of structured securities, consisting of approximately $11.0 billion of Agency RMBS, $2.0 billion of non-Agency RMBS and $1.9 billion of CMBS and we will compete for investment opportunities directly with our Manager or other clients of our Manager or Invesco and its subsidiaries. A substantial number of separate accounts managed by our Manager had limited exposure to our target assets. In addition, in the future our Manager may have additional clients that compete directly with us for investment opportunities, although Invesco has indicated to us that it expects that we will be the only publicly traded REIT advised by our Manager or Invesco and its subsidiaries whose investment strategy is to invest substantially all of its capital in our target assets. Our Manager and Invesco Aim Advisors have an investment allocation policy in place that is intended to enable us to share equitably with the investment companies and institutional and separately managed accounts that effect securities transactions in fixed income securities for which our Manager and Invesco Aim Advisors are responsible in the selection of brokers, dealers and other trading counterparties. According to this policy, investments may be allocated by taking into account factors, including but not limited to investment objectives or strategies, the size of the available investment, cash availability and cash flow expectations, and the tax implications of an investment. The investment allocation policy also requires a fair and equitable allocation of financing opportunities over time among us and other accounts. The investment allocation policy also includes other procedures intended to prevent any of its other accounts from receiving favorable treatment in accessing investment opportunities over any other account. The investment allocation policy may be amended by our Manager and Invesco Aim Advisors at anytime without our consent. To the extent that a conflict arises with respect to the business of our Manager or Invesco Aim Advisors or us in such a way as to give rise to conflicts not currently addressed by the investment allocation policy, our Manager and Invesco Aim Advisors may need to refine its policy to address such situation. Our independent directors will review our Manager s and Invesco Aim Advisors compliance with the investment allocation policy. In addition, to avoid any actual or perceived conflicts of interest with our Manager or Invesco Aim Advisors, a majority of our independent directors will be required to approve an investment in any security structured or issued by an entity managed by our Manager, Invesco Aim Advisors, or any of their affiliates, or any purchase or sale of our assets by or to our Manager, Invesco Aim Advisors or their affiliates or an entity managed by our Manager, Invesco Aim Advisors or its affiliates.

To the extent available to us, we may seek to finance our non-Agency RMBS and CMBS portfolios with financings under the Legacy Securities Program, and, if the program delay is removed, we may also seek to acquire residential and commercial mortgage loans with financing under the Legacy Loan Program. One of the ways we may access this financing is by contributing our equity capital to one or more Legacy Securities or Legacy Loan PPIFs that will be established and managed by our Manager or one of its affiliates. To date, the terms of any equity investment that we would make to any Legacy Securities or Legacy Loan PPIFs that may be established in the future have not yet been determined. However, we expect that any investment we make will be on terms that are no less favorable to us than those made available to other third party institutional investors in the Legacy Securities or Legacy Loan PPIF. In addition, to the extent we pay any fees to our Manager or any of its affiliates in connection with any PPIF, our Manager has agreed to reduce the management fee payable by us under the management agreement (but not below zero) in respect of any equity investment we may decide to make in any PPIF managed by our Manager or any of its affiliates by the amount of the fees payable to our Manager or its affiliates under the PPIF with regard to our equity investment. However, our Manager s management fee will not be reduced in respect of any equity investment we may decide to make in a Legacy Securities or Legacy Loan PPIF managed by an entity other than our Manager or any of its affiliates. Our Manager would have a conflict of interest in recommending our participation in any Legacy Securities or Legacy Loan PPIFs it manages for the fees payable to it by the Legacy Securities or Legacy Loan PPIF may be greater than the fees payable to it by us under the management agreement. We have addressed this conflict by requiring that the terms of any equity investment we make in any such Legacy Securities or Legacy Loan PPIF be approved by our board of directors, including a majority of our independent directors.

We do not have a policy that expressly prohibits our directors, officers, security holders or affiliates from engaging for their own account in business activities of the types conducted by us. However, subject to Invesco s allocation policy, our code of business conduct and ethics contains a conflicts of interest policy that prohibits our directors, officers and personnel, as well as employees of our Manager who provide services to us, from engaging in any transaction that involves an actual conflict of interest with us.

Operating and Regulatory Structure

REIT Qualification

We intend to elect to qualify as a REIT under Sections 856 through 859 of the Internal Revenue Code commencing with our taxable year ending on December 31, 2009. Our qualification as a REIT depends upon our ability to meet on a continuing basis, through actual investment and operating results, various complex requirements under the Internal Revenue Code relating to, among other things, the sources of our gross income, the composition and values of our assets, our distribution levels and the diversity of ownership of our shares. We believe that we have been organized in conformity with the requirements for qualification and taxation as a REIT under the Internal Revenue Code, and that our intended manner of operation will enable us to meet the requirements for qualification and taxation as a REIT.

So long as we qualify as a REIT, we generally will not be subject to U.S. federal income tax on our net taxable income we distribute currently to our stockholders. If we fail to qualify as a REIT in any taxable year and do not qualify for certain statutory relief provisions, we will be subject to U.S. federal income tax at regular corporate rates and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year during which we lost our REIT qualification. Even if we qualify for taxation as a REIT, we may be subject to certain U.S. federal, state and local taxes on our income or property.

1940 Act Exemption

We intend to conduct our operations so that we are not required to register as an investment company under the 1940 Act. Section 3(a)(1)(A) of the 1940 Act defines an investment company as any issuer that is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities. Section 3(a)(1)(C) of the 1940 Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer s total assets (exclusive of U.S. Government securities and cash items) on an unconsolidated basis, which we refer to as the 40% test. Excluded from the term investment securities, among other things, are U.S. Government securities and securities issued by majority-owned subsidiaries that are not themselves investment companies and are not relying on the exception from the definition of investment company set forth in Section 3(c)(1) or Section 3(c)(7) of the 1940 Act. The company is organized as a holding company that conducts its businesses primarily through the operating partnership. Both the company and the operating partnership intend to conduct

Table of Contents

their operations so that they comply with the 40% test. The securities issued to our operating partnership by any wholly owned or majority-owned subsidiaries that we may form in the future that are excepted from the definition of investment company based on Section 3(c)(1) or 3(c)(7) of the 1940 Act, together with any other investment securities the operating partnership may own, may not have a value in excess of 40% of the value of the operating partnership s total assets on an unconsolidated basis. We will monitor our holdings to ensure continuing and ongoing compliance with this test. In addition, we believe neither the company nor the operating partnership will be considered an investment company under Section 3(a)(1)(A) of the 1940 Act because it will not engage primarily or hold itself out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through the operating partnership s wholly owned or majority-owned subsidiaries, the company and the operating partnership will be primarily engaged in the non-investment company businesses of these subsidiaries.

IAS Asset I LLC intends to qualify for an exemption from registration as an investment company under the 1940 Act pursuant to Section 3(c)(5)(C) of the 1940 Act, which is available for entities primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. In addition, certain of the operating partnership s other subsidiaries that we may form in the future also intend to rely on the Section 3(c)(5)(C) exemption. This exemption generally requires that at least 55% of our subsidiaries portfolios must be comprised of qualifying assets and at least another 25% of each of their portfolios must be comprised of real estate-related assets under the 1940 Act (and no more than 20% comprised of miscellaneous assets). Qualifying assets for this purpose include mortgage loans and other assets, such as whole pool Agency RMBS, that the Securities and Exchange Commission, or SEC, staff in various no-action letters has determined are the functional equivalent of mortgage loans for the purposes of the 1940 Act. We intend to treat as real estate-related assets non-Agency RMBS, CMBS, debt and equity securities of companies primarily engaged in real estate businesses, agency partial pool certificates and securities issued by pass-through entities of which substantially all of the assets consist of qualifying assets and/or real estate-related assets. Any Legacy Securities PPIF that may be formed and managed by our Manager or one of its affiliates will rely on Section 3(c)(7) for its 1940 Act exemption. The terms of our participation in any such Legacy Securities PPIF have not as yet been established. As a result, the treatment of IAS Asset I LLC s participation in any Legacy Securities PPIF as a real estate-related asset or a miscellaneous asset for purposes of its Section 3(c)(5)(C) analysis has not been determined. We will discuss with the SEC staff how IAS Asset I LLC s participation in any Legacy Securities PPIF should be treated for purposes of its Section 3(c)(5)(C) analysis. Depending on this determination, we may need to adjust IAS Asset I LLC s assets and strategy in order for it to continue to rely on Section 3(c)(5)(C) for its 1940 Act exemption. Any such adjustment in IAS Asset I LLC s assets or strategy is not expected to have a material adverse effect on our business or strategy. Although we intend to monitor our portfolio periodically and prior to each investment acquisition, there can be no assurance that we will be able to maintain this exemption from registration for each of these subsidiaries.

We may in the future organize special purpose subsidiaries of the operating partnership that will borrow under the TALF. We expect that these TALF subsidiaries will rely on Section 3(c)(7) for their 1940 Act exemption and, therefore, the operating partnership s interest in each of these TALF subsidiaries would constitute an investment security for purposes of determining whether the operating partnership passes the 40% test. We may in the future organize one or more TALF subsidiaries that seek to rely on the 1940 Act exemption provided to certain structured financing vehicles by Rule 3a-7. Any such TALF subsidiary would need to be structured to comply with any guidance that may be issued by the Division of Investment Management of the SEC on the restrictions contained in Rule 3a-7. In certain circumstances, compliance with Rule 3a-7 may require, among other things, that the indenture governing the TALF subsidiary include limitations on the types of assets the subsidiary may sell or acquire out of the proceeds of assets that mature, are refinanced or otherwise sold, on the period of time during which such transactions may occur, and on the level of transactions that may occur. We expect that the aggregate value of the operating partnership s interests in TALF subsidiaries that seek to rely on Rule 3a-7 will comprise less than 20% of the operating partnership s (and, therefore, the company s) total assets on an unconsolidated basis.

18

We expect that IAS Asset I LLC and most of our other majority-owned subsidiaries will not be relying on exemptions under either Section 3(c)(1) or 3(c)(7) of the 1940 Act. Consequently, we expect that our interests in these subsidiaries (which we expect will constitute a substantial majority of our assets) will not constitute investment securities. Consequently, we expect to be able to conduct our operations so that we are not required to register as an investment company under the 1940 Act.

The determination of whether an entity is a majority-owned subsidiary of our company is made by us. The 1940 Act defines a majority-owned subsidiary of a person as a company 50% or more of the outstanding voting securities of which are owned by such person, or by another company which is a majority-owned subsidiary of such person. The 1940 Act further defines voting securities as any security presently entitling the owner or holder thereof to vote for the election of directors of a company. We treat companies in which we own at least a majority of the outstanding voting securities as majority-owned subsidiaries for purposes of the 40% test. We have not requested the SEC to approve our treatment of any company as a majority-owned subsidiary and the SEC has not done so. If the SEC were to disagree with our treatment of one or more companies as majority-owned subsidiaries, we would need to adjust our strategy and our assets in order to continue to pass the 40% test. Any such adjustment in our strategy could have a material adverse effect on us.

Qualification for exemption from registration under the 1940 Act will limit our ability to make certain investments. For example, these restrictions will limit the ability of our subsidiaries to invest directly in mortgage-backed securities that represent less than the entire ownership in a pool of mortgage loans, debt and equity tranches of securitizations and certain ABS and real estate companies or in assets not related to real estate.

To the extent that the SEC staff provides more specific guidance regarding any of the matters bearing upon such exclusions, we may be required to adjust our strategy accordingly. Any additional guidance from the SEC staff could provide additional flexibility to us, or it could further inhibit our ability to pursue the strategies we have chosen.

Restrictions on Ownership of Our Common Stock

To assist us in complying with the limitations on the concentration of ownership of a REIT imposed by the Internal Revenue Code, our charter prohibits, with certain exceptions, any stockholder from beneficially or constructively owning, applying certain attribution rules under the Internal Revenue Code, more than 9.8% by value or number of shares, whichever is more restrictive, of our outstanding shares of common stock, or 9.8% by value or number of shares, whichever is more restrictive, of our outstanding capital stock. Our board of directors may, in its sole discretion, waive the 9.8% ownership limit with respect to a particular stockholder if it is presented with evidence satisfactory to it that such ownership will not then or in the future jeopardize our qualification as a REIT. In addition, different ownership limits will apply to Invesco. These ownership limits, which our board of directors has determined will not jeopardize our REIT qualification, will allow Invesco to hold up to 25% (by value or by number of shares, whichever is more restrictive) of our common stock or up to 25% (by value or by number of shares, whichever is more restrictive) of our outstanding capital stock.

Our charter also prohibits any person from, among other things:

- beneficially or constructively owning shares of our capital stock that would result in our being closely held under Section 856(h) of the Internal Revenue Code, or otherwise cause us to fail to qualify as a REIT; and

- transferring shares of our capital stock if such transfer would result in our capital stock being owned by fewer than 100 persons.

In addition, our charter provides that any ownership or purported transfer of our capital stock in violation of the foregoing restrictions will result in the shares so owned or transferred being automatically transferred to a charitable trust for the benefit of a charitable beneficiary, and the purported owner or transferee acquiring no rights in such shares. If a transfer to a charitable trust would be ineffective for any reason to prevent a violation of the restriction, the transfer resulting in such violation will be void from the time of such purported transfer.

THE OFFERING

Common stock offered by us	8,500,000 shares (plus up to an additional 1,275,000 shares of our common stock that we may issue and sell upon the exercise of the underwriters over-allotment option).
Common stock to be outstanding after this offering and the concurrent private placement to Invesco	10,000,100 shares.[(1)]
Use of proceeds	We intend to invest the net proceeds of this offering and the concurrent private placement of common stock and OP units to the Invesco Purchaser in our target assets. Our Manager will make determinations as to the percentage of our assets that will be invested in each of our target assets. Based on prevailing market conditions, our current expectation is that our initial investment portfolio will consist of between 45% to 55% non-Agency RMBS, 10% to 15% CMBS and the balance in Agency RMBS. However, there is no assurance that upon the completion of this offering we will not allocate the proceeds from this offering and concurrent private placement in a different manner among our target assets. Our decisions will depend on prevailing market conditions and may change over time in response to opportunities available in different interest rate, economic and credit environments. Until appropriate investments can be identified, our Manager may invest these funds in interest-bearing short-term investments, including money market accounts and/or funds, that are consistent with our intention to qualify as a REIT. These initial investments are expected to provide a lower net return than we will seek to achieve from investments in our target assets. See Use of Proceeds.
Distribution policy	We intend to make regular quarterly distributions to holders of our common stock. U.S. federal income tax law generally requires that a REIT distribute annually at least 90% of its REIT taxable income, without regard to the deduction for dividends paid and excluding net capital gains, and that it pay tax at regular corporate rates to the extent that it annually distributes less than 100% of its net taxable income. We generally intend over time to pay quarterly dividends in an amount equal to our net taxable income. We plan to pay our first dividend in respect of the period from the closing of this offering through September 30, 2009 which may be prior to the time that we have fully invested the net proceeds from this offering in investments in our target assets. Any distributions we make will be at the discretion of our board of directors and will depend upon, among other things, our actual results of operations. These results and our ability to pay distributions will be affected by various factors, including the net interest and other income from our portfolio, our operating expenses and any other expenditures. For

more information, see Distribution Policy.

(1) Includes 75,000 shares of our common stock to be sold to Invesco, through our Manager, and shares that may be issued by us upon a redemption of all of the 1,425,000 OP units to be sold to Invesco, through Invesco Investments (Bermuda) Ltd., in each case, in a private placement concurrent with this offering. Excludes 1,275,000 shares of our common stock that we may issue and sell upon the exercise of the underwriters over-allotment option in full.

Proposed NYSE symbol	IVR
Ownership and transfer restrictions	To assist us in complying with limitations on the concentration of ownership of a REIT imposed by the Internal Revenue Code and for other purposes, our charter generally prohibits, among other prohibitions, any stockholder from beneficially or constructively owning more than 9.8% by value or number of shares, whichever is more restrictive, of our outstanding shares of common stock, or 9.8% by value or number of shares, whichever is more restrictive, of our outstanding capital stock. Different ownership limits will apply to Invesco and its direct and indirect subsidiaries, including but not limited to our Manager and Invesco Investments (Bermuda) Ltd. See Description of Capital Stock Restrictions on Ownership and Transfer.
Risk factors	Investing in our common stock involves a high degree of risk. You should carefully read and consider the information set forth under the heading Risk Factors beginning on page 22 of this prospectus and all other information in this prospectus before investing in our common stock.

Our Corporate Information

Our principal executive offices are located at 1555 Peachtree Street, NE, Atlanta, Georgia 30309. Our telephone number is (404) 892-0896. Our website is www.invescomortgagecapital.com. The contents of our website are not a part of this prospectus. The information on our website is not intended to form a part of or be incorporated by reference into this prospectus.

RISK FACTORS

Investing in our common stock involves a high degree of risk. You should carefully consider the following risk factors and all other information contained in this prospectus before purchasing our common stock. If any of the following risks occur, our business, financial condition or results of operations could be materially and adversely affected. In that case, the trading price of our common stock could decline, and you may lose some or all of your investment.

Risks Related to Our Relationship With Our Manager

We are dependent on our Manager and its key personnel for our success. In addition, we intend to rely on our financing opportunities relating to our repurchase agreement financing that have been and will be facilitated and/or provided by Invesco Aim Advisors, an affiliate of our Manager.

We have no separate facilities and are completely reliant on our Manager. We do not expect to have any employees. Our executive officers are employees of Invesco. Our Manager has significant discretion as to the implementation of our investment and operating policies and strategies. Accordingly, we believe that our success will depend to a significant extent upon the efforts, experience, diligence, skill and network of business contacts of the executive officers and key personnel of our Manager. The executive officers and key personnel of our Manager will evaluate, negotiate, close and monitor our investments; therefore, our success will depend on their continued service. The departure of any of the executive officers or key personnel of our Manager could have a material adverse effect on our performance. In addition, we offer no assurance that our Manager will remain our investment manager or that we will continue to have access to our Manager s principals and professionals. The initial term of our management agreement with our Manager only extends until the second anniversary of the closing of this offering, with automatic one-year renewals thereafter. If the management agreement is terminated and no suitable replacement is found to manage us, we may not be able to execute our business plan. Moreover, our Manager is not obligated to dedicate certain of its personnel exclusively to us nor is it obligated to dedicate any specific portion of its time to our business, and none of our Manager s personnel are contractually dedicated to us under our management agreement with our Manager.

To date, we have signed nine master repurchase agreements with nine financial institutions, including with affiliates of Morgan Stanley & Co. Incorporated and Credit Suisse Securities (USA) LLC, and we are in discussions with nine additional financial institutions for repurchase facilities, in order to finance our acquisitions of Agency RMBS. Our Manager is in the process of securing additional commitments on our behalf from a number of the counterparties with whom Invesco Aim Advisors has long-standing relationships. Therefore, if the management agreement is terminated, we cannot assure you that we would continue to have access to these sources of financing for our investments.

Neither Invesco nor our Manager have any experience operating a REIT or managing a portfolio of our target assets on a leveraged basis and we cannot assure you that our Manager s past experience will be sufficient to successfully manage our business as a REIT with such a portfolio.

Our Manager has never operated a REIT. The REIT provisions of the Internal Revenue Code are complex, and any failure to comply with those provisions in a timely manner could prevent us from qualifying as a REIT or force us to pay unexpected taxes and penalties. In such event, our net income would be reduced and we could incur a loss. In addition, neither Invesco Aim Advisors nor our Manager have experience managing a portfolio of our target assets using leverage.

There are conflicts of interest in our relationship with our Manager and Invesco, which could result in decisions that are not in the best interests of our stockholders.

We are subject to conflicts of interest arising out of our relationship with Invesco and our Manager. Specifically, each of our officers and two of our directors, Mr. Armour and Ms. Dunn Kelley, are employees of Invesco. Our Manager and our executive officers may have conflicts between their duties to us and their duties to, and interests in, Invesco. Our Manager is not required to devote a specific amount of time to our operations. As of March 31, 2009, our Manager managed approximately $177.0 billion of fixed income and real estate investments, including approximately $18.8 billion of structured securities consisting of approximately $11.0 billion of Agency RMBS, $2.0 billion of non-Agency RMBS and $1.9 billion of CMBS, and we will compete for investment opportunities directly with our Manager or other clients of our Manager or Invesco and its subsidiaries. A substantial number of separate accounts managed by our Manager had limited exposure to our target assets. In addition, in the future our Manager may have additional clients that compete directly with us for investment opportunities, although Invesco has indicated to us that it expects that we will be the only publicly traded REIT advised by our Manager or Invesco and its subsidiaries whose investment strategy is to invest substantially all of its capital in our target assets. Our Manager and Invesco Aim Advisors have an investment and financing allocation policy in place intended to enable us to share equitably with the investment companies and institutional and separately managed accounts that effect securities transactions in fixed income securities for which our Manager and Invesco Aim Advisors are responsible in the selection of brokers, dealers and other trading counterparties. Therefore, we may compete with our Manager and Invesco Aim Advisors for investment or financing opportunities sourced by our Manager and Invesco Aim Advisors and, as a result, we may either not be presented with the opportunity or have to compete with our Manager and Invesco Aim Advisors to acquire these investments or have access to these sources of financing. Our Manager and our executive officers may choose to allocate favorable investments to Invesco or other clients of Invesco instead of to us. Further, at times when there are turbulent conditions in the mortgage markets or distress in the credit markets or other times when we will need focused support and assistance from our Manager, Invesco or entities for which our Manager also acts as an investment manager will likewise require greater focus and attention, placing our Manager s resources in high demand. In such situations, we may not receive the level of support and assistance that we may receive if we were internally managed or if our Manager did not act as a manager for other entities. There is no assurance that our Manager s allocation policies that address some of the conflicts relating to our access to investment and financing sources, which are described under Management Conflicts of Interest, will be adequate to address all of the conflicts that may arise.

We will pay our Manager substantial management fees regardless of the performance of our portfolio. Our Manager s entitlement to a management fee, which is not based upon performance metrics or goals, might reduce its incentive to devote its time and effort to seeking investments that provide attractive risk-adjusted returns for our portfolio. This in turn could hurt both our ability to make distributions to our stockholders and the market price of our common stock.

Concurrently with the completion of this offering, we will complete a private placement in which we will sell 75,000 shares of our common stock to Invesco, through our Manager, at $20.00 per share and 1,425,000 OP units to Invesco, through Invesco Investments (Bermuda) Ltd., a wholly owned subsidiary of Invesco, at $20.00 per unit. Upon completion of this offering and the concurrent private placement, Invesco, through our Manager, will beneficially own 0.87% of our common stock (or 0.76% if the underwriters fully exercise their option to purchase additional shares). Assuming that all OP units are redeemed for an equivalent number of shares of our common stock, Invesco, through the Invesco Purchaser, would beneficially own 15% of our outstanding common stock upon completion of this offering and the concurrent private placement (or 13.3% if the underwriters fully exercise their option to purchase additional shares). Each of our Manager and Invesco Investments (Bermuda) Ltd. will agree that, for a period of one year after the date of this prospectus, neither will, without the prior written consent of Credit Suisse Securities (USA) LLC and Morgan Stanley & Co. Incorporated, dispose of or hedge any of the shares of our common stock or OP units that it purchases in the concurrent private placement, subject to extension in certain circumstances. Each of our Manager and Invesco Investments (Bermuda) Ltd. may sell any of these securities at any time following the expiration of this one-year lock-up period. To the extent our Manager or Invesco Investments (Bermuda) Ltd. sell some of these securities, its interests may be less aligned with our interests.

Our Manager would have a conflict in recommending our participation in any Legacy Security or Legacy Loan PPIFs it manages.

To the extent available to us, we may seek to finance our non-Agency RMBS and CMBS portfolios with financings under the Legacy Securities Program, and, if the program delays are removed, we may seek to acquire residential and commercial mortgage loans with financing under the Legacy Loan Program. One of the

Table of Contents

ways we may access this financing is by contributing our equity capital to one or more PPIFs that will be established and managed by our Manager or one of its affiliates. To date, the terms of any equity investment that we would make to any PPIFs that may be established in the future have not yet been determined. Our Manager would have a conflict of interest in recommending our participation in any Legacy Securities or Legacy Loan PPIFs it manages for the fees payable to it by the Legacy Securities or Legacy Loan PPIF may be greater than the fees payable to it by us under the management agreement.

The management agreement with our Manager was not negotiated on an arm s-length basis and may not be as favorable to us as if it had been negotiated with an unaffiliated third party and may be costly and difficult to terminate.

Our executive officers and two of our five directors are employees of Invesco. Our management agreement with our Manager was negotiated between related parties and its terms, including fees payable, may not be as favorable to us as if it had been negotiated with an unaffiliated third party.

Termination of the management agreement with our Manager without cause is difficult and costly. Our independent directors will review our Manager s performance and the management fees annually and, following the initial two-year term, the management agreement may be terminated annually upon the affirmative vote of at least two-thirds of our independent directors based upon: (1) our Manager s unsatisfactory performance that is materially detrimental to us, or (2) a determination that the management fees payable to our Manager are not fair, subject to our Manager s right to prevent termination based on unfair fees by accepting a reduction of management fees agreed to by at least two-thirds of our independent directors. Our Manager will be provided 180 days prior notice of any such termination. Additionally, upon such a termination, the management agreement provides that we will pay our Manager a termination fee equal to three times the sum of the average annual management fee received by our Manager during the prior 24-month period before such termination, calculated as of the end of the most recently completed fiscal quarter. These provisions may increase the cost to us of terminating the management agreement and adversely affect our ability to terminate our Manager without cause.

Our Manager is only contractually committed to serve us until the second anniversary of the closing of this offering. Thereafter, the management agreement is renewable for one-year terms; provided, however, that our Manager may terminate the management agreement annually upon 180 days prior notice. If the management agreement is terminated and no suitable replacement is found to manage us, we may not be able to execute our business plan.

Pursuant to the management agreement, our Manager will not assume any responsibility other than to render the services called for thereunder and will not be responsible for any action of our board of directors in following or declining to follow its advice or recommendations. Our Manager maintains a contractual as opposed to a fiduciary relationship with us. Under the terms of the management agreement, our Manager, its officers, stockholders, members, managers, directors, personnel, any person controlling or controlled by our Manager and any person providing sub-advisory services to our Manager will not be liable to us, any subsidiary of ours, our directors, our stockholders or any subsidiary s stockholders or partners for acts or omissions performed in accordance with and pursuant to the management agreement, except because of acts constituting bad faith, willful misconduct, gross negligence, or reckless disregard of their duties under the management agreement. In addition, we have agreed to indemnify our Manager, its officers, stockholders, members, managers, directors, personnel, any person controlling or controlled by our Manager and any person providing sub-advisory services to our Manager with respect to all expenses, losses, damages, liabilities, demands, charges and claims arising from acts of our Manager not constituting bad faith, willful misconduct, gross negligence, or reckless disregard of duties, performed in good faith in accordance with and pursuant to the management agreement. See Our Manager and the Management Agreement Management Agreement.

Our board of directors will approve very broad investment guidelines for our Manager and will not approve each investment and financing decision made by our Manager.

Our Manager will be authorized to follow very broad investment guidelines. Our board of directors will periodically review our investment guidelines and our investment portfolio but will not, and will not be required to, review all of our proposed investments, except that an investment in a security structured or issued by an entity managed by Invesco must be approved by a majority of our independent directors prior to such investment. In addition, in conducting periodic reviews, our board of directors may rely primarily on information provided to them by our Manager. Furthermore, our Manager may use complex strategies, and transactions entered into by our Manager may be costly, difficult or impossible to unwind by the time they are reviewed by our board of directors. Our Manager will have great latitude within the broad parameters of our investment guidelines in determining the types and amounts of Agency RMBS, non-Agency RMBS, CMBS and mortgage loans it may decide are attractive investments for us, which could result in investment returns that are substantially below expectations or that result in losses, which would materially and adversely affect our business operations and results. Further, decisions made and investments and financing arrangements entered into by our Manager may not fully reflect the best interests of our stockholders.

Risks Related to Our Company

There can be no assurance that the actions of the U.S. Government, Federal Reserve, U.S. Treasury and other governmental and regulatory bodies for the purpose of stabilizing the financial markets, including the establishment of the TALF and the PPIP, or market response to those actions, will achieve the intended effect, and our business may not benefit from these actions and further government or market developments could adversely impact us.

In response to the financial issues affecting the banking system and the financial markets and going concern threats to investment banks and other financial institutions, the U.S. Government, Federal Reserve and U.S. Treasury and other governmental and regulatory bodies have taken action to stabilize the financial markets. Significant measures include: the enactment of the Emergency Economic Stabilization Act of 2008, or the EESA, to, among other things, establish TARP; the enactment of the Housing and Economic Recovery Act of 2008, or the HERA, which established a new regulator for Fannie Mae and Freddie Mac; and the establishment of the TALF and the PPIP.

There can be no assurance that the EESA, HERA, TALF, PPIP or other recent U.S. Government actions will have a beneficial impact on the financial markets, including on current extreme levels of volatility. To the extent the market does not respond favorably to these initiatives or these initiatives do not function as intended, our business may not receive the anticipated positive impact from the legislation. There can also be no assurance that we will be eligible to participate in any programs established by the U.S. Government such as the TALF or the PPIP or, if we are eligible, that we will be able to utilize them successfully or at all. In addition, because the programs are designed, in part, to restart the market for certain of our target assets, the establishment of these programs may result in increased competition for attractive opportunities in our target assets. It is also possible that our competitors may utilize the programs which would provide them with attractive debt and equity capital funding from the U.S. Government. In addition, the U.S. Government, the Federal Reserve, the U.S. Treasury and other governmental and regulatory bodies have taken or are considering taking other actions to address the financial crisis. We cannot predict whether or when such actions may occur, and such actions could have a dramatic impact on our business, results of operations and financial condition.

We may change any of our strategies, policies or procedures without stockholder consent.

We may change any of our strategies, policies or procedures with respect to investments, acquisitions, growth, operations, indebtedness, capitalization and distributions at any time without the consent of our stockholders, which could result in an investment portfolio with a different risk profile. A change in our investment strategy may increase our exposure to interest rate risk, default risk and real estate market fluctuations. Furthermore, a change in our asset allocation could result in our making investments in asset

Table of Contents

categories different from those described in this prospectus. These changes could adversely affect our financial condition, results of operations, the market price of our common stock and our ability to make distributions to our stockholders.

We have no operating history and may not be able to successfully operate our business or generate sufficient revenue to make or sustain distributions to our stockholders.

We were organized in June 2008 and have no operating history. We have no assets and will commence operations only upon completion of this offering. We cannot assure you that we will be able to operate our business successfully or implement our operating policies and strategies as described in this prospectus. The results of our operations depend on several factors, including the availability of opportunities for the acquisition of assets, the level and volatility of interest rates, the availability of adequate short and long-term financing, conditions in the financial markets and economic conditions.

We are highly dependent on information systems and systems failures could significantly disrupt our business, which may, in turn, negatively affect the market price of our common stock and our ability to pay dividends.

Our business is highly dependent on communications and information systems of Invesco. Any failure or interruption of Invesco s systems could cause delays or other problems in our securities trading activities, which could have a material adverse effect on our operating results and negatively affect the market price of our common stock and our ability to pay dividends to our stockholders.

Maintenance of our 1940 Act exemption imposes limits on our operations.

The company intends to conduct its operations so as not to become regulated as an investment company under the 1940 Act. Because the company is a holding company that will conduct its businesses through the operating partnership and its wholly owned or majority-owned subsidiaries, the securities issued by these subsidiaries that are excepted from the definition of investment company under Section 3(c)(1) or Section 3(c)(7) of the 1940 Act, together with any other investment securities the operating partnership may own, may not have a combined value in excess of 40% of the value of the operating partnership s total assets on an unconsolidated basis which we refer to as the 40% test. This requirement limits the types of businesses in which we may engage through our subsidiaries.

IAS Asset I LLC and certain of the operating partnership s other subsidiaries that we may form in the future intend to rely upon the exemption from registration as an investment company under the 1940 Act pursuant to Section 3(c)(5)(C) of the 1940 Act, which is available for entities primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. This exemption generally requires that at least 55% of our subsidiaries portfolios must be comprised of qualifying assets and at least another 25% of each of their portfolios must be comprised of real estate-related assets under the 1940 Act (and no more than 20% comprised of miscellaneous assets). Qualifying assets for this purpose include mortgage loans and other assets, such as whole pool Agency RMBS, that the Securities and Exchange Commission (or SEC) staff in various no-action letters has determined are the functional equivalent of mortgage loans for the purposes of the 1940 Act. We intend to treat as real estate-related assets non-Agency RMBS, CMBS, debt and equity securities of companies primarily engaged in real estate businesses, agency partial pool certificates and securities issued by pass-through entities of which substantially all of the assets consist of qualifying assets and/or real estate-related assets. Any Legacy Securities PPIF that may be formed and managed by our Manager or one of its affiliates will rely on Section 3(c)(7) for its 1940 Act exemption. The terms of our participation in any such Legacy Securities PPIF have not as yet been established. As a result, the treatment of IAS Asset I LLC s participation in any Legacy Securities PPIF as a real estate-related asset or a miscellaneous asset for purposes of its Section 3(c)(5)(C) analysis has not been determined. We will discuss with the SEC staff how IAS Asset I LLC s participation in any Legacy Securities PPIF should be treated for purposes of its

Section 3(c)(5)(C) analysis. Depending on this determination, we may need to adjust IAS Asset I LLC s assets and strategy in order for it to continue to rely on Section 3(c)(5)(C) for its 1940 Act exemption. Any such adjustment in IAS Asset I LLC s assets or strategy is not expected to have a material adverse effect on our business or strategy. Although we intend to monitor our portfolio periodically and prior to each investment acquisition, there can be no assurance that we will be able to maintain this exemption from registration for each of these subsidiaries.

We may in the future organize special purpose subsidiaries of the operating partnership that will borrow under the TALF. We expect that these TALF subsidiaries will rely on Section 3(c)(7) for their 1940 Act exemption and, therefore, the operating partnership s interest in each of these TALF subsidiaries would constitute an investment security for purposes of determining whether the operating partnership passes the 40% test. We may in the future organize one or more TALF subsidiaries that seek to rely on the 1940 Act exemption provided to certain structured financing vehicles by Rule 3a-7. Any such TALF subsidiary would need to be structured to comply with any guidance that may be issued by the Division of Investment Management of the SEC on the restrictions contained in Rule 3a-7. The company expects that the aggregate value of the operating partnership s interests in TALF subsidiaries that seek to rely on Rule 3a-7 will comprise less than 20% of the operating partnership s (and, therefore, the company s) total assets on an unconsolidated basis.

In addition, if we organize special purpose subsidiaries in the future that will borrow under the TALF, we anticipate that some of these subsidiaries may be organized to rely on the 1940 Act exemption provided to certain structured financing vehicles by Rule 3a-7. To the extent that we organize subsidiaries that rely on Rule 3a-7 for an exemption from the 1940 Act, these subsidiaries will need to comply with the restrictions contained in this Rule. In general, Rule 3a-7 exempts from the 1940 Act issuers that limit their activities as follows:

- the issuer issues securities the payment of which depends primarily on the cash flow from eligible assets, which include many of the types of assets that we expect to acquire in our TALF fundings, that by their terms convert into cash within a finite time period;

- the securities sold are fixed income securities rated investment grade by at least one rating agency (fixed income securities which are unrated or rated below investment grade may be sold to institutional accredited investors and any securities may be sold to qualified institutional buyers and to persons involved in the organization or operation of the issuer);

- the issuer acquires and disposes of eligible assets (1) only in accordance with the agreements pursuant to which the securities are issued, (2) so that the acquisition or disposition does not result in a downgrading of the issuer s fixed income securities and (3) the eligible assets are not acquired or disposed of for the primary purpose of recognizing gains or decreasing losses resulting from market value changes; and

- unless the issuer is issuing only commercial paper, the issuer appoints an independent trustee, takes reasonable steps to transfer to the trustee an ownership or perfected security interest in the eligible assets, and meets rating agency requirements for commingling of cash flows.

In addition, in certain circumstances, compliance with Rule 3a-7 may also require, among other things that the indenture governing the subsidiary include additional limitations on the types of assets the subsidiary may sell or acquire out of the proceeds of assets that mature, are refinanced or otherwise sold, on the period of time during which such transactions may occur, and on the level of transactions that may occur. In light of the requirements of Rule 3a-7, our ability to manage assets held in a special purpose subsidiary that complies with Rule 3a-7 will be limited and we may not be able to purchase or sell assets owned by that subsidiary when we would otherwise desire to do so, which could lead to losses.

The determination of whether an entity is a majority-owned subsidiary of our company is made by us. The 1940 Act defines a majority-owned subsidiary of a person as a company 50% or more of the outstanding voting securities of which are owned by such person, or by another company which is a majority-owned subsidiary of such person. The 1940 Act further defines voting securities as any security presently entitling the owner or holder thereof to vote for the election of directors of a company. We treat companies in which we own at least a majority of the outstanding voting securities as majority-owned subsidiaries for purposes of the 40% test. We have not requested the SEC to approve our treatment of any company as a majority-owned subsidiary and the SEC has not done so. If the SEC were to disagree with our treatment of one or more companies as majority-owned subsidiaries, we would need to adjust our strategy and our assets in order to continue to pass the 40% test. Any such adjustment in our strategy could have a material adverse effect on us.

Qualification for exemption from registration under the 1940 Act will limit our ability to make certain investments. For example, these restrictions will limit the ability of our subsidiaries to invest directly in mortgage-backed securities that represent less than the entire ownership in a pool of mortgage loans, debt and equity tranches of securitizations and certain ABS and real estate companies or in assets not related to real estate.

There can be no assurance that the laws and regulations governing the 1940 Act status of REITs, including the Division of Investment Management of the SEC providing more specific or different guidance regarding these exemptions, will not change in a manner that adversely affects our operations. To the extent that the SEC staff provides more specific guidance regarding any of the matters bearing upon such exclusions, we may be required to adjust our strategy accordingly. Any additional guidance from the SEC staff could provide additional flexibility to us, or it could further inhibit our ability to pursue the strategies we have chosen. If we, the operating partnership or its subsidiaries fail to maintain an exception or exemption from the 1940 Act, we could, among other things, be required either to (a) change the manner in which we conduct our operations to avoid being required to register as an investment company, (b) effect sales of our assets in a manner that, or at a time when, we would not otherwise choose to do so, or (c) register as an investment company, any of which could negatively affect the value of our common stock, the sustainability of our business model, and our ability to make distributions which could have an adverse effect on our business and the market price for our shares of common stock.

Risks Related to Financing and Hedging

We expect to use leverage in executing our business strategy, which may adversely affect the return on our assets and may reduce cash available for distribution to our stockholders, as well as increase losses when economic conditions are unfavorable.

We expect to use leverage to finance our assets through borrowings from repurchase agreements, to the extent available to us, borrowings under programs established by the U.S. Government such as the TALF, and other secured and unsecured forms of borrowing and, if available, we may make investments in funds that receive financing under the PPIP. Initially, we do not expect to deploy leverage on our non-Agency RMBS, CMBS and mortgage loan assets, except with borrowings, to the extent available to us, under programs established by the U.S. Government. Although we are not required to maintain any particular assets-to-equity leverage ratio, the amount of leverage we may deploy for particular assets will depend upon our Manager s assessment of the credit and other risks of those assets. We expect, initially, that we may deploy, on a debt-to-equity basis, up to seven to eight times leverage on our Agency RMBS assets and approximately five to six times leverage on our non-Agency RMBS, CMBS and mortgage loan assets. We consider these initial leverage ratios to be prudent for these asset classes.

The capital and credit markets have been experiencing extreme volatility and disruption since July 2007. In recent months, the volatility and disruption have reached unprecedented levels. In a large number of cases, the markets have exerted downward pressure on stock prices and credit capacity for issuers. Our access to capital depends upon a number of factors over which we have little or no control, including:

- general market conditions;
- the market s view of the quality of our assets;
- the market s perception of our growth potential;

our eligibility to participate in and access capital from programs established by the U.S. Government;

our current and potential future earnings and cash distributions; and

the market price of the shares of our capital stock.

The current weakness in the financial markets, the residential and commercial mortgage markets and the economy generally could adversely affect one or more of our potential lenders and could cause one or more of our potential lenders to be unwilling or unable to provide us with financing or to increase the costs of that financing. Current market conditions have affected different types of financing for mortgage-related assets to varying degrees, with some sources generally being unavailable, others being available but at a higher cost, while others being largely unaffected. For example, in the repurchase agreement market, non-Agency RMBS have been more difficult to finance than Agency RMBS. In connection with repurchase agreements, financing rates and advance rates, or haircut levels, have also increased. Repurchase agreement counterparties have taken these steps in order to compensate themselves for a perceived increased risk due to the illiquidity of the underlying collateral. In some cases, margin calls have forced borrowers to liquidate collateral in order to meet the capital requirements of these margin calls, resulting in losses.

The return on our assets and cash available for distribution to our stockholders may be reduced to the extent that market conditions prevent us from leveraging our assets or cause the cost of our financing to increase relative to the income that can be derived from the assets acquired. Our financing costs will reduce cash available for distributions to stockholders. We may not be able to meet our financing obligations and, to the extent that we cannot, we risk the loss of some or all of our assets to liquidation or sale to satisfy the obligations. We plan to leverage our Agency RMBS through repurchase agreements. A decrease in the value of these assets may lead to margin calls which we will have to satisfy. We may not have the funds available to satisfy any such margin calls and may be forced to sell assets at significantly depressed prices due to market conditions or otherwise, which may result in losses. The satisfaction of such margin calls may reduce cash flow available for distribution to our stockholders. Any reduction in distributions to our stockholders may cause the value of our common stock to decline.

As a result of recent market events, including the contraction among and failure of certain lenders, it may be more difficult for us to secure non-governmental financing.

Our results of operations are materially affected by conditions in the financial markets and the economy generally. Recently, concerns over inflation, energy price volatility, geopolitical issues, unemployment, the availability and cost of credit, the mortgage market and a declining real estate market have contributed to increased volatility and diminished expectations for the economy and markets.

Dramatic declines in the residential and commercial real estate markets, with decreasing home prices and increasing foreclosures and unemployment, have resulted in significant asset write-downs by financial institutions, which have caused many financial institutions to seek additional capital, to merge with other institutions and, in some cases, to fail. We rely on the availability of repurchase agreement financing to acquire Agency RMBS on a leveraged basis. Although, to the extent available to us, we initially may use U.S. Government financing to acquire our other target assets, we may in the future seek private funding sources to acquire these assets as well. Institutions from which we seek to obtain financing may have owned or financed residential or commercial mortgage loans, real estate-related securities and real estate loans which have declined in value and caused losses as a result of the recent downturn in the markets. Many lenders and institutional investors have reduced and, in some cases, ceased to provide funding to borrowers, including other financial institutions. If these conditions persist, these institutions may become insolvent. As a result of recent market events, it may be more difficult for us to secure non-governmental financing as there are fewer institutional lenders and those remaining lenders have tightened their lending standards.

If a counterparty to our repurchase transactions defaults on its obligation to resell the underlying security back to us at the end of the transaction term, or if the value of the underlying security has declined as of the end of that term, or if we default on our obligations under the repurchase agreement, we will lose money on our repurchase transactions.

When we engage in repurchase transactions, we generally sell securities to lenders (repurchase agreement counterparties) and receive cash from these lenders. The lenders are obligated to resell the same securities back to us at the end of the term of the transaction. Because the cash we receive from the lender when we initially sell the securities to the lender is less than the value of those securities (this difference is the haircut), if the lender defaults on its obligation to resell the same securities back to us we may incur a loss on the transaction equal to the amount of the haircut (assuming there was no change in the value of the securities). We would also lose money on a repurchase transaction if the value of the underlying securities has declined as of the end of the transaction term, as we would have to repurchase the securities for their initial value but would receive securities worth less than that amount. Further, if we default on one of our obligations under a repurchase transaction, the lender can terminate the transaction and cease entering into any other repurchase transactions with us. We expect our repurchase agreements will contain cross-default provisions, so that if a default occurs under any one agreement, the lenders under our other agreements could also declare a default. Any losses we incur on our repurchase transactions could adversely affect our earnings and thus our cash available for distribution to our stockholders.

Our use of repurchase agreements to finance our Agency RMBS may give our lenders greater rights in the event that either we or a lender files for bankruptcy.

Our borrowings under repurchase agreements for our Agency RMBS may qualify for special treatment under the U.S. Bankruptcy Code, giving our lenders the ability to avoid the automatic stay provisions of the U.S. Bankruptcy Code and to take possession of and liquidate the assets that we have pledged under their repurchase agreements without delay in the event that we file for bankruptcy. Furthermore, the special treatment of repurchase agreements under the U.S. Bankruptcy Code may make it difficult for us to recover our pledged assets in the event that a lender party to such agreement files for bankruptcy. Therefore, our use of repurchase agreements to finance our investments exposes our pledged assets to risk in the event of a bankruptcy filing by either a lender or us.

We will depend on repurchase agreement financing to acquire Agency RMBS, and our inability to access this funding for our Agency RMBS could have a material adverse effect on our results of operations, financial condition and business.

We may use repurchase agreement financing as a strategy to increase the return on our assets. However, we may not be able to achieve our desired leverage ratio for a number of reasons, including if the following events occur:

- our lenders do not make repurchase agreement financing available to us at acceptable rates;
- certain of our lenders exit the repurchase market;
- our lenders require that we pledge additional collateral to cover our borrowings, which we may be unable to do; or
- we determine that the leverage would expose us to excessive risk.

Our ability to fund our Agency RMBS may be impacted by our ability to secure repurchase agreement financing on acceptable terms. We can provide no assurance that lenders will be willing or able to provide us with sufficient financing. In addition, because repurchase agreements are short term commitments of capital, lenders may respond to market conditions making it more difficult for us to secure continued financing. During certain periods of the credit cycle, lenders may curtail their willingness to provide financing.

If major market participants continue to exit the repurchase agreement financing business, the value of our Agency RMBS could be negatively impacted, thus reducing net stockholder equity, or book value. Furthermore, if many of our potential lenders are unwilling or unable to provide us with repurchase agreement financing, we could be forced to sell our Agency RMBS assets at an inopportune time when prices are depressed. In addition, if the regulatory capital requirements imposed on our lenders change, they may be required to significantly increase the cost of the financing that they provide to us. Our lenders also may revise their eligibility requirements for the types of assets they are willing to finance or the terms of such financings, based on, among other factors, the regulatory environment and their management of perceived risk, particularly with respect to assignee liability. Moreover, the amount of financing we will receive under our repurchase agreements will be directly related to the lenders valuation of the Agency RMBS that secure the outstanding borrowings. Typically repurchase agreements grant the respective lender the absolute right to reevaluate the market value of the assets that secure outstanding borrowings at any time. If a lender determines in its sole discretion that the value of the assets has decreased, it has the right to initiate a margin call. A margin call would require us to transfer additional assets to such lender without any advance of funds from the lender for such transfer or to repay a portion of the outstanding borrowings. Any such margin call could have a material adverse effect on our results of operations, financial condition, business, liquidity and ability to make distributions to our stockholders, and could cause the value of our common stock to decline. We may be forced to sell assets at significantly depressed prices to meet such margin calls and to maintain adequate liquidity, which could cause us to incur losses. Moreover, to the extent we are forced to sell assets at such time, given market conditions, we may be selling at the same time as others facing similar pressures, which could exacerbate a difficult market environment and which could result in our incurring significantly greater losses on our sale of such assets. In an extreme case of market duress, a market may not even be present for certain of our assets at any price.

Our liquidity may also be adversely affected by margin calls under repurchase agreements for our Agency RMBS because we will be dependent in part on the lenders valuation of the collateral securing the financing. Any such margin call could harm our liquidity, results of operation, and financial condition. Additionally, in order to obtain cash to satisfy a margin call, we may be required to liquidate assets at a disadvantageous time, which could cause us to incur further losses and adversely affect our results of operations and financial condition.

The current dislocations in the residential and commercial mortgage sector could cause one or more of our potential lenders to be unwilling or unable to provide us with financing for our target assets on attractive terms or at all.

The current dislocations in the residential mortgage sector have caused many lenders to tighten their lending standards, reduce their lending capacity or exit the market altogether. Further contraction among lenders, insolvency of lenders or other general market disruptions could adversely affect one or more of our potential lenders and could cause one or more of our potential lenders to be unwilling or unable to provide us with financing on attractive terms or at all. This could increase our financing costs and reduce our access to liquidity. If one or more major market participants fails or otherwise experiences a major liquidity crisis, as was the case for Bear Stearns & Co. in March 2008 and Lehman Brothers Holdings Inc. in September 2008, it could negatively impact the marketability of all fixed income securities, including our target assets, and this could negatively impact the value of the assets we acquire, thus reducing our net book value. Furthermore, if many of our potential lenders are unwilling or unable to provide us with financing, we could be forced to sell our assets at an inopportune time when prices are depressed.

The repurchase agreements that we will use to finance our investments may require us to provide additional collateral and may restrict us from leveraging our assets as fully as desired.

We intend to use repurchase agreements to finance our acquisition of Agency RMBS. If the market value of the Agency RMBS pledged or sold by us to a financing institution declines, we may be required by the financing institution to provide additional collateral or pay down a portion of the funds advanced, but we may not have the funds available to do so, which could result in defaults. Posting additional collateral to support our credit will reduce our liquidity and limit our ability to leverage our assets, which could adversely affect our business. In the event we do not have sufficient liquidity to meet such requirements, financing institutions can accelerate repayment of our indebtedness, increase interest rates, liquidate our collateral or terminate our ability to borrow. Such a situation would likely result in a rapid deterioration of our financial condition and possibly necessitate a filing for bankruptcy protection.

Further, financial institutions providing the repurchase facilities may require us to maintain a certain amount of cash uninvested or to set aside non-levered assets sufficient to maintain a specified liquidity position which would allow us to satisfy our collateral obligations. As a result, we may not be able to leverage our assets as fully as we would choose, which could reduce our return on equity. If we are unable to meet these collateral obligations, our financial condition could deteriorate rapidly.

Lenders may require us to enter into restrictive covenants relating to our operations.

When we obtain financing, lenders could impose restrictions on us that would affect our ability to incur additional debt, our capability to make distributions to stockholders and our flexibility to determine our operating policies. Loan documents we execute may contain negative covenants that limit, among other things, our ability to repurchase stock, distribute more than a certain amount of our funds from operations, and employ leverage beyond certain amounts.

An increase in our borrowing costs relative to the interest we receive on investments in our target assets may adversely affect our profitability, and our cash available for distribution to our stockholders.

As our financings mature, we will be required either to enter into new borrowings or to sell certain of our investments. An increase in short-term interest rates at the time that we seek to enter into new borrowings would reduce the spread between our returns on our assets and the cost of our borrowings. This would adversely affect our returns on our assets, which might reduce earnings and, in turn, cash available for distribution to our stockholders.

We may use U.S. government equity and debt financing to acquire our non-Agency RMBS, CMBS and mortgage loan portfolio.

We may seek to acquire non-Agency RMBS and CMBS with financings under the TALF. On March 23, 2009, the U.S. Treasury announced preliminary plans to expand the TALF to include non-Agency RMBS and CMBS that were originally rated AAA. On May 1, 2009, the Federal Reserve published the terms for the expansion of TALF to CMBS and announced that, beginning on June 16, 2009, up to $100 billion of TALF loans will be available to finance purchases of CMBS created on or after January 1, 2009. Additionally, on May 19, 2009, the Federal Reserve announced that certain high quality legacy CMBS, including CMBS issued before January 1, 2009, would become eligible collateral under the TALF starting in July 2009. However, the TALF has not yet been expanded to cover any other CMBS. In addition, to date, neither the FRBNY nor the U.S. Treasury has announced how the TALF will be expanded to non- Agency RMBS. There can no assurance that the TALF will be expanded to include these asset classes and, if so expanded, that we will be able to utilize this program successfully or at all.

We may also seek to acquire non-Agency RMBS and CMBS with financings under the Legacy Securities Program. However, the equity and debt financing under the Legacy Securities Program are available to Legacy Securities PPIFs managed by investment managers who have been selected as a Legacy Securities PPIF asset manager under the program. Invesco has applied to serve as one of the investment managers for the Legacy Securities Program. However, there can be no assurance that Invesco will be selected for this role.

We may also acquire residential and commercial mortgage loans with financing under the Legacy Loan Program. However, the details of this program are still emerging and there can no assurance that we will be eligible to participate in this program or, if we are eligible, that we will be able to utilize it successfully or at all.

Risks Relating to the PPIP and TALF

The terms and conditions of the PPIP have not been finalized and there is no assurance it will be finalized or that the final terms will enable us to participate in the PPIP in a manner consistent with our investment strategy.

While the U.S. Treasury and the FDIC have released a summary of proposed terms and conditions for the PPIP, they have not released the final terms and conditions governing these programs and there is no assurance that these programs will be finalized. The existing proposed terms and conditions do not address the specific terms and conditions relating to: (1) the guaranteed debt to be issued by participants in the Legacy Loan Program, (2) the debt financing from the U.S. Treasury in the Legacy Securities Program and (3) the warrants the U.S. Treasury will receive under both programs. In addition, the U.S. Treasury and the FDIC have reserved the right to modify the proposed terms of the PPIP. If final terms and conditions are released, there is no assurance that we will be able to participate in the PPIP in a manner acceptable to us consistent with our investment strategy.

The terms and conditions of the TALF may change, which could adversely affect our investments.

The terms and conditions of the TALF, including asset and borrower eligibility, could be changed at any time. Any such modifications may adversely affect the market value of any of our assets financed through the TALF or our ability to obtain additional TALF financing. If the TALF is prematurely discontinued or reduced while our assets financed through the TALF are still outstanding, there may be no market for these assets and the market value of these assets would be adversely affected.

There is no assurance that we will be able to participate in the PPIP or, if we are able to participate, that funding will be available.

Investors in the Legacy Loan Program must be pre-qualified by the FDIC. The FDIC has complete discretion regarding the qualification of investors in the Legacy Loan Program and is under no obligation to approve Invesco s participation even if it meets all of the applicable criteria.

Requests for funding under the PPIP may surpass the amount of funding authorized by the U.S. Treasury, resulting in an early termination of the PPIP. In addition, under the terms of the Legacy Securities Program, the U.S. Treasury has the right to cease funding of committed but undrawn equity capital and debt financing to a specific fund participating in the Legacy Securities Program in its sole discretion. We may be unable to obtain capital and debt financing on similar terms and such actions may adversely affect our ability to purchase eligible assets and may otherwise affect expected returns on our investments.

There is no assurance that we will be able to obtain any TALF loans.

The TALF is to be operated by the FRBNY. The FRBNY has complete discretion regarding the extension of credit under the TALF and is under no obligation to make any loans to us even if we meet all of the applicable criteria. Requests for TALF loans may surpass the amount of funding authorized by the Federal Reserve and the U.S. Treasury, resulting in an early termination of the TALF. Depending on the demand for TALF loans and the general state of the credit markets, the Federal Reserve and the U.S. Treasury may decide to modify the terms and conditions of the TALF. Such actions may adversely affect our ability to obtain TALF loans and use the loan leverage to enhance returns, and may otherwise affect expected returns on our investments.

We could lose our eligibility as a TALF borrower, which would adversely affect our ability to fulfill our investment objectives.

Any U.S. company is permitted to participate in the TALF, provided that it maintains an account relationship with a primary dealer. An entity is a U.S. company for purposes of the TALF if it is (1) a business entity or institution that is organized under the laws of the United States or a political subdivision or territory thereof (U.S.-organized) and conducts significant operations or activities in the United States, including any U.S.-organized subsidiary of such an entity; (2) a U.S. branch or agency of a non-U.S. bank (other than a foreign central bank) that maintains reserves with a Federal Reserve Bank; (3) a U.S. insured depository institution; or (4) an investment fund that is U.S.-organized and managed by an investment manager that has its principal place of business in the United States. An entity that satisfies any one of the requirements above is a U.S. company regardless of whether it is controlled by, or managed by, a company that is not U.S.-organized. Notwithstanding the foregoing, a U.S. company excludes any entity, other than those described in clauses (2) and (3) above, that is controlled by a non-U.S. government or is managed by an investment manager controlled by a non-U.S. government, other than those described in clauses (2) and (3) above. For these purposes, a non-U.S. government controls a company if, among other things, such non-U.S. government owns, controls, or holds with power to vote 25% or more of a class of voting securities of the company. The application of these rules under the TALF is not clear. For instance, it is uncertain how a change of control subsequent to a stockholders purchase of shares of common stock which results in such shareholder being

Table of Contents

owned or controlled by a non-U.S. government will be treated for purposes of the 25% limitation. If for any reason we are deemed not to be eligible to participate in the TALF, all of our outstanding TALF loans will become immediately due and payable and we will not be eligible to obtain future TALF loans.

It may be difficult to acquire sufficient amounts of eligible assets to qualify to participate in the PPIP or the TALF consistent with our investment strategy.

Assets to be used as collateral for PPIP and TALF loans must meet strict eligibility criteria with respect to characteristics such as issuance date, maturity, and credit rating and with respect to the origination date of the underlying collateral. These restrictions may limit the availability of eligible assets, and it may be difficult to acquire sufficient amounts of assets to obtain financing under the PPIP and TALF consistent with our investment strategy.

In the Legacy Loan Program, eligible financial institutions must consult with the FDIC before offering an asset pool for sale and there is no assurance that a sufficient number of eligible financial institutions will be willing to participate as sellers in the Legacy Loan Program.

Once an asset pool has been offered for sale by an eligible financial institution, the FDIC will determine the amount of leverage available to finance the purchase of the asset pool. There is no assurance that the amount of leverage available to finance the purchase of eligible assets will be acceptable to our Manager.

The asset pools will be purchased through a competitive auction conducted by the FDIC. The auction process may increase the price of these eligible asset pools. Even if a fund in which we invest submits the winning bid on an eligible asset pool at a price that is acceptable to the fund, the selling financial institution may refuse to sell to the fund the eligible asset pool at that price.

These factors may limit the availability of eligible assets, and it may be difficult to acquire sufficient amounts of assets to obtain financing under the Legacy Loan Program consistent with our investment strategy.

It may be difficult to transfer any assets purchased using PPIP and TALF funding.

Any assets purchased using funding will be pledged to the FRBNY as collateral for the TALF loans. Transfer or sale of any of these assets requires repayment of the related TALF loan or the consent of the FRBNY to assign obligations under the related TALF loan to the applicable assignee. The FRBNY in its discretion may restrict or prevent assignment of loan obligations to a third party, including a third party that meets the criteria of an eligible borrower. In addition, the FRBNY will not consent to any assignments after the termination date for making new loans, which is December 31, 2009, unless extended by the Federal Reserve.

Any assets purchased using PPIP funding, to the extent available, will be pledged to the FDIC as collateral for their guarantee under the Legacy Loan Program and to the U.S. Treasury as collateral for debt financing under the Legacy Securities Program. Transfer or sale of any of these assets requires repayment of the related loan or the consent of the FDIC or the U.S. Treasury to assign obligations to the applicable assignee. The FDIC or the U.S. Treasury, each in its discretion, may restrict or prevent assignment of obligations to a third party, including a third party that meets the criteria for participation in the PPIP.

These restrictions may limit our ability to trade or otherwise dispose of our investments, and may adversely affect our ability to take advantage of favorable market conditions and make distributions to stockholders.

We may need to surrender eligible TALF assets to repay TALF loans at maturity.

Each TALF loan must be repaid within three to five years. We intend to invest in CMBS that do not mature within the term of the TALF loan. If we do not have sufficient funds to repay interest and principal on the related TALF loan at maturity and if these assets cannot be sold for an amount equal to or greater than the amount owed on such loan, we must surrender the assets to the FRBNY in lieu of repayment. If we are forced to sell any assets to repay a TALF loan, we may not be able to obtain a favorable price. If we default on our obligation to pay a TALF loan and the FRBNY elects to liquidate the assets used as collateral to secure such

TALF loan, the proceeds from that sale will be applied, first, to any enforcement costs, second, to unpaid principal and, finally, to unpaid interest. Under the terms of the TALF, if assets are surrendered to the FRBNY in lieu of repayment, all assets that collateralize that loan must be surrendered. In these situations, we would forfeit any equity that we held in these assets.

FRBNY consent is required to exercise our voting rights on CMBS.

As a requirement of the TALF, we must agree not to exercise or refrain from exercising any voting, consent or waiver rights under a CMBS without the consent of the FRBNY. During the continuance of a collateral enforcement event, the FRBNY will have the right to exercise voting rights in the collateral.

We will be dependent on the activities of our primary dealers.

To obtain TALF loans, we must execute a customer agreement with at least one primary dealer which will act on our behalf under the agreement with the FRBNY. The primary dealer will submit aggregate loan request amounts on behalf of its customers in the form and manner specified by the FRBNY. Each primary dealer is required to apply its internal customer identification program and due diligence procedures to each borrower and represent that each borrower is an eligible borrower for purposes of the TALF, and to provide the FRBNY with information sufficient to describe the dealer s customer risk assessment methodology. These customer agreements may impose additional requirements that could affect our ability to obtain TALF loans. Each primary dealer is expected to have relationships with other TALF borrowers, and a primary dealer may allocate more resources toward assisting other borrowers with whom it has other business dealings. Primary dealers are also responsible for distributing principal and interest after receipt thereof from The Bank of New York Mellon, as custodian for the TALF. Once funds or collateral are transferred to a primary dealer or at the direction of a primary dealer, neither the custodian nor the FRBNY has any obligation to account for whether the funds or collateral are transferred to the borrower. We will therefore be exposed to bankruptcy risk of our primary dealers.

We will be subject to interest rate risk, which can adversely affect our net income.

We expect interest rates on fixed-rate TALF loans will be set at a premium over the then-current three-year or five-year LIBOR swap rate. As a result, we may be exposed to (1) timing risk between the dates on which payments are received on assets financed through the TALF and the dates on which interest payments are due on the TALF loans and (2) asset/liability repricing risk, due to differences in the dates and indices on which floating rates on the financed assets and on the related TALF loans are reset.

Our ability to receive the interest earnings may be limited.

We expect to make interest payments on any TALF loan from the interest paid to us on the assets used as collateral for the TALF loan. To the extent that we receive distributions from pledged assets in excess of our required interest payments on a TALF loan during any loan year, the amount of excess interest we may retain will be limited.

Under certain conditions, we may be required to provide full recourse for TALF loans or to make indemnification payments.

To participate in the TALF, we must execute a customer agreement with a primary dealer authorizing it, among other things, to act as our agent under TALF and to act on our behalf under the agreement with the FRBNY and with The Bank of New York Mellon as administrator and as the FRBNY s custodian of the CMBS. Under such agreements, we will be required to represent to the primary dealer and to the FRBNY that, among other things, we are an eligible borrower and that the CMBS that we pledge meet the TALF eligibility criteria. The FRBNY will have full recourse to us for repayment of the loan for any breach of these representations. Further, the FRBNY may have full recourse to us for repayment of a TALF loan if the eligibility criteria for collateral under the TALF are considered continuing requirements and the pledged collateral no longer satisfies such criteria. In addition, we will be required to pay to our primary dealers fees under the customer agreements and to indemnify our primary dealers for certain breaches under the customer agreements and to indemnify the FRBNY and its custodian for certain breaches under the agreement with the FRBNY. Payments made to satisfy such full recourse requirements and indemnities could have a material adverse effect on our net income and our distributions to our stockholders, including any proceeds of this offering that we have not yet invested in CMBS or distributed to our stockholders.

Changes in accounting treatment may adversely affect our reported profitability.

In February 2008, the Financial Accounting Standards Board, or FASB, issued final guidance regarding the accounting and financial statement presentation for transactions that involve the acquisition of Agency RMBS from a counterparty and the subsequent financing of these securities through repurchase agreements with the same counterparty. We will evaluate our position based on the final guidance issued by FASB. If we do not meet the criteria under the final guidance to account for the transactions on a gross basis, our accounting treatment would not affect the economics of these transactions, but would affect how these transactions are reported on our financial statements. If we are not able to comply with the criteria under this final guidance for same party transactions we would be precluded from presenting Agency RMBS and the related financings, as well as the related interest income and interest expense, on a gross basis on our financial statements. Instead, we would be required to account for the purchase commitment and related repurchase agreement on a net basis and record a forward commitment to purchase Agency RMBS as a derivative instrument. Such forward commitments would be recorded at fair value with subsequent changes in fair value recognized in earnings. Additionally, we would record the cash portion of our investment in Agency RMBS as a mortgage related receivable from the counterparty on our balance sheet. Although we would not expect this change in presentation to have a material impact on our net income, it could have an adverse impact on our operations. It could have an impact on our ability to include certain Agency RMBS purchased and simultaneously financed from the same counterparty as qualifying real estate interests or real estate-related assets used to qualify under the exemption to not have to register as an investment company under the 1940 Act. It could also limit our investment opportunities as we may need to limit our purchases of Agency RMBS that are simultaneously financed with the same counterparty.

We may enter into hedging transactions that could expose us to contingent liabilities in the future.

Subject to maintaining our qualification as a REIT, part of our investment strategy will involve entering into hedging transactions that could require us to fund cash payments in certain circumstances (such as the early termination of the hedging instrument caused by an event of default or other early termination event, or the decision by a counterparty to request margin securities it is contractually owed under the terms of the hedging instrument). The amount due would be equal to the unrealized loss of the open swap positions with the respective counterparty and could also include other fees and charges. These economic losses will be reflected in our results of operations, and our ability to fund these obligations will depend on the liquidity of our assets and access to capital at the time, and the need to fund these obligations could adversely impact our financial condition.

Hedging against interest rate exposure may adversely affect our earnings, which could reduce our cash available for distribution to our stockholders.

Subject to maintaining our qualification as a REIT, we intend to pursue various hedging strategies to seek to reduce our exposure to adverse changes in interest rates. Our hedging activity will vary in scope based on the level and volatility of interest rates, the type of assets held and other changing market conditions. Interest rate hedging may fail to protect or could adversely affect us because, among other things:

- interest rate hedging can be expensive, particularly during periods of rising and volatile interest rates;

available interest rate hedges may not correspond directly with the interest rate risk for which protection is sought;

due to a credit loss, the duration of the hedge may not match the duration of the related liability;

the amount of income that a REIT may earn from hedging transactions (other than hedging transactions that satisfy certain requirements of the Internal Revenue Code or that are done through a TRS) to offset interest rate losses is limited by U.S. federal tax provisions governing REITs;

the credit quality of the hedging counterparty owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and

the hedging counterparty owing money in the hedging transaction may default on its obligation to pay.

Our hedging transactions, which are intended to limit losses, may actually adversely affect our earnings, which could reduce our cash available for distribution to our stockholders.

In addition, hedging instruments involve risk since they often are not traded on regulated exchanges, guaranteed by an exchange or its clearing house, or regulated by any U.S. or foreign governmental authorities. Consequently, there are no requirements with respect to record keeping, financial responsibility or segregation of customer funds and positions. Furthermore, the enforceability of agreements underlying hedging transactions may depend on compliance with applicable statutory and commodity and other regulatory requirements and, depending on the identity of the counterparty, applicable international requirements. The business failure of a hedging counterparty with whom we enter into a hedging transaction will most likely result in its default. Default by a party with whom we enter into a hedging transaction may result in the loss of unrealized profits and force us to cover our commitments, if any, at the then current market price. Although generally we will seek to reserve the right to terminate our hedging positions, it may not always be possible to dispose of or close out a hedging position without the consent of the hedging counterparty and we may not be able to enter into an offsetting contract in order to cover our risk. We cannot assure you that a liquid secondary market will exist for hedging instruments purchased or sold, and we may be required to maintain a position until exercise or expiration, which could result in losses.

We may fail to qualify for hedge accounting treatment.

We intend to record derivative and hedging transactions in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, or SFAS 133. Under these standards, we may fail to qualify for hedge accounting treatment for a number of reasons, including if we use instruments that do not meet the SFAS 133 definition of a derivative (such as short sales), we fail to satisfy SFAS 133 hedge documentation and hedge effectiveness assessment requirements or our instruments are not highly effective. If we fail to qualify for hedge accounting treatment, our operating results may suffer because losses on the derivatives that we enter into may not be offset by a change in the fair value of the related hedged transaction.

We have limited experience in making critical accounting estimates, and our financial statements may be materially affected if our estimates prove to be inaccurate.

Financial statements prepared in accordance with GAAP require the use of estimates, judgments and assumptions that affect the reported amounts. Different estimates, judgments and assumptions reasonably could be used that would have a material effect on the financial statements, and changes in these estimates, judgments and assumptions are likely to occur from period to period in the future. Significant areas of accounting requiring the application of management s judgment include, but are not limited to (1) assessing the adequacy of the allowance for loan losses and (2) determining the fair value of investment securities. These estimates, judgments and assumptions are inherently uncertain, and, if they prove to be wrong, then we face the risk that charges to income will be required. In addition, because we have limited operating history in some of these areas and limited experience in making these estimates, judgments and assumptions, the risk of future charges to income may be greater than if we had more experience in these areas. Any such charges could significantly harm our business, financial condition, results of operations and the price of our securities. See Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies for a discussion of the accounting estimates, judgments and assumptions that we believe are the most critical to an understanding of our business, financial condition and results of operations.

Risks Related to Our Investments

We have not yet identified any specific investments in our target assets.

We have not yet identified any specific investments for our portfolio and, thus, you will not be able to evaluate any proposed investments before purchasing shares of our common stock. Additionally, our investments will be selected by our Manager and our stockholders will not have input into such investment decisions. Both of these factors will increase the uncertainty, and thus the risk, of investing in shares of our common stock.

Until appropriate investments can be identified, our Manager may invest the net proceeds of this offering and the concurrent private offering in interest-bearing short-term investments, including money market accounts and/or funds, that are consistent with our intention to qualify as a REIT. These investments are expected to provide a lower net return than we will seek to achieve from investments in our target assets. We expect to reallocate a portion of the net proceeds from these offerings into a portfolio of our target assets within three months, subject to the availability of appropriate investment opportunities, although Invesco has indicated to us that it expects that we will be the only publicly traded REIT advised by our Manager or Invesco and its subsidiaries whose investment strategy is to invest substantially all of its capital in our target assets. Our Manager intends to conduct due diligence with respect to each investment and suitable investment opportunities may not be immediately available. Even if opportunities are available, there can be no assurance that our Manager s due diligence processes will uncover all relevant facts or that any investment will be successful.

We may allocate the net proceeds from this offering and the concurrent private placement to investments with which you may not agree.

You will be unable to evaluate the manner in which the net proceeds of these offerings will be invested or the economic merit of our expected investments and, as a result, we may use the net proceeds from these offerings to invest in investments with which you may not agree. The failure of our management to apply these proceeds effectively or find investments that meet our investment criteria in sufficient time or on acceptable terms could result in unfavorable returns, could cause a material adverse effect on our business, financial condition, liquidity, results of operations and ability to make distributions to our stockholders, and could cause the value of our common stock to decline.

Because assets we expect to acquire may experience periods of illiquidity, we may lose profits or be prevented from earning capital gains if we cannot sell mortgage-related assets at an opportune time.

We bear the risk of being unable to dispose of our target assets at advantageous times or in a timely manner because mortgage-related assets generally experience periods of illiquidity, including the recent period of delinquencies and defaults with respect to residential and commercial mortgage loans. The lack of liquidity may result from the absence of a willing buyer or an established market for these assets, as well as legal or contractual restrictions on resale or the unavailability of financing for these assets. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited, which may cause us to incur losses.

The lack of liquidity in our investments may adversely affect our business.

We expect that the assets that we will acquire will not be publicly traded. A portion of these securities may be subject to legal and other restrictions on resale or will otherwise be less liquid than publicly-traded securities. The illiquidity of our investments may make it difficult for us to sell such investments if the need or desire arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded our investments. Further, we may face other restrictions on our ability to liquidate an investment in a business entity to the extent that we or our Manager has or could be attributed with material, non-public information regarding such business entity. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited, which could adversely affect our results of operations and financial condition.

Our investments may be concentrated and will be subject to risk of default.

While we intend to diversify our portfolio of investments in the manner described in this prospectus, we are not required to observe specific diversification criteria, except as may be set forth in the investment guidelines adopted by our board of directors. Therefore, our investments in our target assets may at times be concentrated in certain property types that are subject to higher risk of foreclosure, or secured by properties concentrated in a limited number of geographic locations. To the extent that our portfolio is concentrated in any one region or type of security, downturns relating generally to such region or type of security may result in defaults on a number of our investments within a short time period, which may reduce our net income and the value of our common stock and accordingly reduce our ability to pay dividends to our stockholders.

Difficult conditions in the mortgage, residential and commercial real estate markets may cause us to experience market losses related to our holdings, and we do not expect these conditions to improve in the near future.

Our results of operations are materially affected by conditions in the mortgage market, the residential and commercial real estate markets, the financial markets and the economy generally. Recently, concerns about the mortgage market and a declining real estate market, as well as inflation, energy costs, geopolitical issues and the availability and cost of credit, have contributed to increased volatility and diminished expectations for the economy and markets going forward. The mortgage market has been severely affected by changes in the lending landscape and there is no assurance that these conditions have stabilized or that they will not worsen. The disruption in the mortgage market has an impact on new demand for homes, which will compress the home ownership rates and weigh heavily on future home price performance. There is a strong correlation between home price growth rates and mortgage loan delinquencies. The further deterioration of the RMBS market may cause us to experience losses related to our assets and to sell assets at a loss. Declines in the market values of our investments may adversely affect our results of operations and credit availability, which may reduce earnings and, in turn, cash available for distribution to our stockholders.

Dramatic declines in the residential and commercial real estate markets, with falling home prices and increasing foreclosures and unemployment, have resulted in significant asset write-downs by financial institutions, which have caused many financial institutions to seek additional capital, to merge with other institutions and, in some cases, to fail. Institutions from which we may seek to obtain financing may have owned or financed residential or commercial mortgage loans, real estate-related securities and real estate loans, which have declined in value and caused them to suffer losses as a result of the recent downturn in the residential and commercial mortgage markets. Many lenders and institutional investors have reduced and, in some cases, ceased to provide funding to borrowers, including other financial institutions. If these conditions persist, these institutions may become insolvent or tighten their lending standards, which could make it more difficult for us to obtain financing on favorable terms or at all. Our profitability may be adversely affected if we are unable to obtain cost-effective financing for our assets.

Continued adverse developments in the residential and commercial mortgage markets, including recent increases in defaults, credit losses and liquidity concerns, could make it difficult for us to borrow money to acquire our target assets on a leveraged basis, on attractive terms or at all, which could adversely affect our profitability.

Since mid-2008, there have been several announcements of proposed mergers, acquisitions or bankruptcies of investment banks and commercial banks that have historically acted as repurchase agreement counterparties. This has resulted in a fewer number of potential repurchase agreement counterparties operating in the market. In addition, many commercial banks, investment banks and insurance companies have announced extensive losses from exposure to the residential and commercial mortgage markets. These losses have reduced financial industry capital, leading to reduced liquidity for some institutions. Many of these institutions may have owned or financed assets which have declined in value and caused them to suffer losses, enter bankruptcy proceedings, further tighten their lending standards or increase the amount of equity capital or haircut required to obtain financing. These difficulties have resulted in part from declining markets for their mortgage loans as well as from claims for repurchases of mortgage loans previously sold under provisions that require repurchase in the event of early payment defaults or for breaches of representations regarding loan quality. In addition, a rising interest rate environment and declining real estate values may decrease the number of borrowers seeking or able to refinance their mortgage loans, which would result in a decrease in overall originations. In addition, the Federal Reserve s program to purchase Agency RMBS could cause an increase in the price of Agency RMBS, which would negatively impact the net interest margin with respect to Agency RMBS we expect to purchase. The general market conditions discussed above may make it difficult or more expensive for us to obtain financing on attractive terms or at all, and our profitability may be adversely affected if we were unable to obtain cost-effective financing for our investments.

We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments in our target assets and could also affect the pricing of these securities.

We operate in a highly competitive market for investment opportunities. Our profitability depends, in large part, on our ability to acquire our target assets at attractive prices. In acquiring our target assets, we will compete with a variety of institutional investors, including other REITs, specialty finance companies, public and private funds (including other funds managed by Invesco), commercial and investment banks, commercial finance and insurance companies and other financial institutions. Many of our competitors are substantially larger and have considerably greater financial, technical, marketing and other resources than we do. Several other REITs have recently raised, or are expected to raise, significant amounts of capital, and may have investment objectives that overlap with ours, which may create additional competition for investment opportunities. Some competitors may have a lower cost of funds and access to funding sources that may not be available to us, such as funding from the U.S. Government, if we are not eligible to participate in programs established by the U.S. Government. Many of our competitors are not subject to the operating constraints associated with REIT tax compliance or maintenance of an exemption from the 1940 Act. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, competition for investments in our target assets may lead to the price of such assets increasing, which may further limit our ability to generate desired returns. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. Also, as a result of this competition, desirable investments in our target assets may be limited in the future and we may not be able to take advantage of attractive investment opportunities from time to time, as we can provide no assurance that we will be able to identify and make investments that are consistent with our investment objectives. In addition, the Federal Reserve s program to purchase Agency RMBS could cause an increase in the price of Agency RMBS, which would negatively impact the net interest margin with respect to Agency RMBS we expect to purchase.

We may acquire non-Agency RMBS collateralized by subprime and Alt A mortgage loans, which are subject to increased risks.

We may acquire non-Agency RMBS backed by collateral pools of mortgage loans that have been originated using underwriting standards that are less restrictive than those used in underwriting prime mortgage loans and Alt A mortgage loans. These lower standards include mortgage loans made to borrowers having imperfect or impaired credit histories, mortgage loans where the amount of the loan at origination is 80% or more of the value of the mortgage property, mortgage loans made to borrowers with low credit scores, mortgage loans made to borrowers who have other debt that represents a large portion of their income and mortgage loans made to borrowers whose income is not required to be disclosed or verified. Due to economic conditions, including increased interest rates and lower home prices, as well as aggressive lending practices, subprime mortgage loans have in recent periods experienced increased rates of delinquency, foreclosure, bankruptcy and loss, and they are likely to continue to experience delinquency, foreclosure, bankruptcy and loss rates that are higher, and that may be substantially higher, than those experienced by mortgage loans underwritten in a more traditional manner. Thus, because of the higher delinquency rates and losses associated with subprime mortgage loans, the performance of non-Agency RMBS backed by subprime

mortgage loans that we may acquire could be correspondingly adversely affected, which could adversely impact our results of operations, financial condition and business.

The mortgage loans that we will acquire, and the mortgage and other loans underlying the non-Agency RMBS and CMBS that we will acquire, are subject to defaults, foreclosure timeline extension, fraud and commercial and residential price depreciation, and unfavorable modification of loan principal amount, interest rate and amortization of principal, which could result in losses to us.

Residential mortgage loans are secured by single family residential property and are subject to risks of delinquency and foreclosure and risks of loss. The ability of a borrower to repay a loan secured by a residential property typically is dependent upon the income or assets of the borrower. A number of factors, including a general economic downturn, acts of God, terrorism, social unrest and civil disturbances, may impair borrowers abilities to repay their loans. In addition, we intend to acquire non-Agency RMBS, which are backed by residential real property but, in contrast to Agency RMBS, their principal and interest are not guaranteed by federally chartered entities such as Fannie Mae and Freddie Mac and, in the case of Ginnie Mae, the U.S. Government. The ability of a borrower to repay these loans or other financial assets is dependent upon the income or assets of these borrowers.

CMBS are secured by a single commercial mortgage loan or a pool of commercial mortgage loans. Accordingly, the CMBS we invest in is subject to all of the risks of the respective underlying commercial mortgage loans. Commercial mortgage loans are secured by multifamily or commercial property and are subject to risks of delinquency and foreclosure, and risks of loss that are greater than similar risks associated with loans made on the security of single-family residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced, the borrower s ability to repay the loan may be impaired.

In the event of any default under a mortgage loan held directly by us, we will bear a risk of loss of principal to the extent of any deficiency between the value of the collateral and the principal and accrued interest of the mortgage loan, which could have a material adverse effect on our cash flow from operations. In the event of the bankruptcy of a mortgage loan borrower, the mortgage loan to such borrower will be deemed to be secured only to the extent of the value of the underlying collateral at the time of bankruptcy (as determined by the bankruptcy court), and the lien securing the mortgage loan will be subject to the avoidance powers of the bankruptcy trustee or debtor in possession to the extent the lien is unenforceable under state law. Foreclosure of a mortgage loan can be an expensive and lengthy process which could have a substantial negative effect on our anticipated return on the foreclosed mortgage loan.

Agency RMBS are subject to risks particular to investments secured by mortgage loans on residential real property.

Our investments in Agency RMBS will be subject to the risks of defaults, foreclosure timeline extension, fraud and home price depreciation and unfavorable modification of loan principal amount, interest rate and amortization of principal, accompanying the underlying residential mortgage loans. The ability of a borrower to repay a mortgage loan secured by a residential property is dependent upon the income or assets of the borrower. A number of factors may impair borrowers abilities to repay their loans, including:

- acts of God, including earthquakes, floods and other natural disasters, which may result in uninsured losses;

- acts of war or terrorism, including the consequences of terrorist attacks, such as those that occurred on September 11, 2001;

- adverse changes in national and local economic and market conditions;

changes in governmental laws and regulations, fiscal policies and zoning ordinances and the related costs of compliance with laws and regulations, fiscal policies and ordinances;

costs of remediation and liabilities associated with environmental conditions such as indoor mold; and

the potential for uninsured or under-insured property losses.

In the event of defaults on the residential mortgage loans that underlie our investments in Agency RMBS and the exhaustion of any underlying or any additional credit support, we may not realize our anticipated return on our investments and we may incur a loss on these investments.

The commercial mortgage loans we expect to acquire and the commercial mortgage loans underlying the CMBS we may acquire will be subject to defaults, foreclosure timeline extension, fraud and home price depreciation and unfavorable modification of loan principal amount, interest rate and amortization of principal.

Commercial mortgage loans are secured by multifamily or commercial property and are subject to risks of delinquency and foreclosure, and risks of loss that may be greater than similar risks associated with loans made on the security of single-family residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced, the borrower s ability to repay the loan may be impaired. Net operating income of an income-producing property can be affected by, among other things,

tenant mix;

success of tenant businesses;

property management decisions;

property location and condition;

competition from comparable types of properties;

changes in laws that increase operating expenses or limit rents that may be charged;

any need to address environmental contamination at the property or the occurrence of any uninsured casualty at the property;

changes in national, regional or local economic conditions and/or specific industry segments;

declines in regional or local real estate values;

declines in regional or local rental or occupancy rates;

increases in interest rates;

real estate tax rates and other operating expenses;

changes in governmental rules, regulations and fiscal policies, including environmental legislation; and

acts of God, terrorist attacks, social unrest and civil disturbances.

In the event of any default under a mortgage loan held directly by us, we will bear a risk of loss of principal to the extent of any deficiency between the value of the collateral and the principal and accrued interest of the mortgage loan, which could have a material adverse effect on our cash flow from operations and limit amounts available for distribution to our stockholders. In the event of the bankruptcy of a mortgage loan borrower, the mortgage loan to such borrower will be deemed to be secured only to the extent of the value of the underlying collateral at the time of bankruptcy (as determined by the bankruptcy court), and the lien securing the mortgage loan will be subject to the avoidance powers of the bankruptcy trustee or debtor-in-possession to the extent the lien is unenforceable under state law. Foreclosure of a mortgage loan can be an expensive and lengthy process, which could have a substantial negative effect on our anticipated return on the foreclosed mortgage loan.

Table of Contents

Our investments in CMBS are generally subject to losses.

We may acquire CMBS. In general, losses on a mortgaged property securing a mortgage loan included in a securitization will be borne first by the equity holder of the property, then by a cash reserve fund or letter of credit, if any, then by the holder of a mezzanine loan or B-Note, if any, then by the first loss subordinated security holder (generally, the B-Piece buyer) and then by the holder of a higher-rated security. In the event of default and the exhaustion of any equity support, reserve fund, letter of credit, mezzanine loans or B-Notes, and any classes of securities junior to those in which we invest, we will not be able to recover all of our investment in the securities we purchase. In addition, if the underlying mortgage portfolio has been overvalued by the originator, or if the values subsequently decline and, as a result, less collateral is available to satisfy interest and principal payments due on the related MBS. The prices of lower credit quality securities are generally less sensitive to interest rate changes than more highly rated investments, but more sensitive to adverse economic downturns or individual issuer developments.

We may not control the special servicing of the mortgage loans included in the CMBS in which we invest and, in such cases, the special servicer may take actions that could adversely affect our interests.

With respect to each series of CMBS in which we invest, overall control over the special servicing of the related underlying mortgage loans will be held by a directing certificateholder or a controlling class representative, which is appointed by the holders of the most subordinate class of CMBS in such series. Since we will focus on acquiring classes of existing series of CMBS originally rated AAA, we will not have the right to appoint the directing certificateholder. In connection with the servicing of the specially serviced mortgage loans, the related special servicer may, at the direction of the directing certificateholder, take actions with respect to the specially serviced mortgage loans that could adversely affect our interests.

If our Manager overestimates the loss-adjusted yields of our CMBS investments, we may experience losses.

Our Manager will value our potential CMBS investments based on loss-adjusted yields, taking into account estimated future losses on the mortgage loans included in the securitization s pool of loans, and the estimated impact of these losses on expected future cash flows. Based on these loss estimates, our Manager will either adjust the pool composition accordingly through loan removals and other credit enhancement mechanisms or leave loans in place and negotiate for a price adjustment. Our Manager s loss estimates may not prove accurate, as actual results may vary from estimates. In the event that our Manager overestimates the pool level losses relative to the price we pay for a particular CMBS investment, we may experience losses with respect to such investment.

The B-Notes we may acquire may be subject to additional risks related to the privately negotiated structure and terms of the transaction, which may result in losses to us.

We may acquire B-Notes. A B-Note is a mortgage loan typically (1) secured by a first mortgage on a single large commercial property or group of related properties and (2) subordinated to an A-Note secured by the same first mortgage on the same collateral. As a result, if a borrower defaults, there may not be sufficient funds remaining for B-Note holders after payment to the A-Note holders. However, because each transaction is privately negotiated, B-Notes can vary in their structural characteristics and risks. For example, the rights of holders of B-Notes to control the process following a borrower default may vary from transaction to transaction. Further, B-Notes typically are secured by a single property and so reflect the risks associated with significant concentration. Significant losses related to our B-Notes would result in operating losses for us and may limit our ability to make distributions to our stockholders.

Our mezzanine loan assets will involve greater risks of loss than senior loans secured by income-producing properties.

We may acquire mezzanine loans, which take the form of subordinated loans secured by second mortgages on the underlying property or loans secured by a pledge of the ownership interests of either the entity owning the property or a pledge of the ownership interests of the entity that owns the interest in the entity owning the property. These types of assets involve a higher degree of risk than long-term senior mortgage lending secured by income-producing real property, because the loan may become unsecured as a result of foreclosure by the senior lender. In the event of a bankruptcy of the entity providing the pledge of its ownership interests as security, we may not have full recourse to the assets of such entity, or the assets of the entity may not be sufficient to satisfy our mezzanine loan. If a borrower defaults on our mezzanine loan or debt senior to our loan, or in the event of a borrower bankruptcy, our mezzanine loan will be satisfied only after the senior debt. As a result, we may not recover some or all of our initial expenditure. In addition, mezzanine loans may have higher loan-to-value ratios than conventional mortgage loans, resulting in less equity in the property and increasing the risk of loss of principal. Significant losses related to our mezzanine loans would result in operating losses for us and may limit our ability to make distributions to our stockholders.

Bridge loans will involve a greater risk of loss than traditional investment-grade mortgage loans with fully insured borrowers.

We may acquire bridge loans secured by first lien mortgages on a property to borrowers who are typically seeking short-term capital to be used in an acquisition, construction or redevelopment of a property. The borrower has usually identified an undervalued asset that has been under-managed and/or is located in a recovering market. If the market in which the asset is located fails to recover according to the borrower s projections, or if the borrower fails to improve the quality of the asset s management and/or the value of the asset, the borrower may not receive a sufficient return on the asset to satisfy the bridge loan, and we bear the risk that we may not recover some or all of our initial expenditure.

In addition, borrowers usually use the proceeds of a conventional mortgage to repay a bridge loan. Bridge loans therefore are subject to risks of a borrower s inability to obtain permanent financing to repay the bridge loan. Bridge loans are also subject to risks of borrower defaults, bankruptcies, fraud, losses and special hazard losses that are not covered by standard hazard insurance. In the event of any default under bridge loans held by us, we bear the risk of loss of principal and non-payment of interest and fees to the extent of any deficiency between the value of the mortgage collateral and the principal amount of the bridge loan. To the extent we suffer such losses with respect to our bridge loans, the value of our company and the price of our shares of common stock may be adversely affected.

Increases in interest rates could adversely affect the value of our investments and cause our interest expense to increase, which could result in reduced earnings or losses and negatively affect our profitability as well as the cash available for distribution to our stockholders.

We expect to invest in Agency RMBS, non-Agency RMBS, CMBS and mortgage loans. In a normal yield curve environment, an investment in such assets will generally decline in value if long-term interest rates increase. Declines in market value may ultimately reduce earnings or result in losses to us, which may negatively affect cash available for distribution to our stockholders.

A significant risk associated with our target assets is the risk that both long-term and short-term interest rates will increase significantly. If long-term rates increased significantly, the market value of these investments would decline, and the duration and weighted average life of the investments would increase. We could realize a loss if the securities were sold. At the same time, an increase in short-term interest rates would increase the amount of interest owed on the repurchase agreements we may enter into to finance the purchase of Agency RMBS.

Market values of our investments may decline without any general increase in interest rates for a number of reasons, such as increases or expected increases in defaults, or increases or expected increases in voluntary prepayments for those investments that are subject to prepayment risk or widening of credit spreads.

In addition, in a period of rising interest rates, our operating results will depend in large part on the difference between the income from our assets and financing costs. We anticipate that, in most cases, the income from such assets will respond more slowly to interest rate fluctuations than the cost of our borrowings.

Consequently, changes in interest rates, particularly short-term interest rates, may significantly influence our net income. Increases in these rates will tend to decrease our net income and market value of our assets.

An increase in interest rates may cause a decrease in the volume of certain of our target assets which could adversely affect our ability to acquire target assets that satisfy our investment objectives and to generate income and pay dividends.

Rising interest rates generally reduce the demand for mortgage loans due to the higher cost of borrowing. A reduction in the volume of mortgage loans originated may affect the volume of our target assets available to us, which could adversely affect our ability to acquire assets that satisfy our investment objectives. Rising interest rates may also cause our target assets that were issued prior to an interest rate increase to provide yields that are below prevailing market interest rates. If rising interest rates cause us to be unable to acquire a sufficient volume of our target assets with a yield that is above our borrowing cost, our ability to satisfy our investment objectives and to generate income and pay dividends may be materially and adversely affected.

The relationship between short-term and longer-term interest rates is often referred to as the yield curve. Ordinarily, short-term interest rates are lower than longer-term interest rates. If short-term interest rates rise disproportionately relative to longer-term interest rates (a flattening of the yield curve), our borrowing costs may increase more rapidly than the interest income earned on our assets. Because we expect our investments, on average, generally will bear interest based on longer-term rates than our borrowings, a flattening of the yield curve would tend to decrease our net income and the market value of our net assets. Additionally, to the extent cash flows from investments that return scheduled and unscheduled principal are reinvested, the spread between the yields on the new investments and available borrowing rates may decline, which would likely decrease our net income. It is also possible that short-term interest rates may exceed longer-term interest rates (a yield curve inversion), in which event our borrowing costs may exceed our interest income and we could incur operating losses.

Interest rate fluctuations may adversely affect the level of our net income and the value of our assets and common stock.

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. Interest rate fluctuations present a variety of risks, including the risk of a narrowing of the difference between asset yields and borrowing rates, flattening or inversion of the yield curve and fluctuating prepayment rates, and may adversely affect our income and the value of our assets and common stock.

Interest rate mismatches between our Agency RMBS backed by ARMs or hybrid ARMs and our borrowings used to fund our purchases of these assets may reduce our net interest income and cause us to suffer a loss during periods of rising interest rates.

We expect to fund most of our investments in Agency RMBS with borrowings that have interest rates that adjust more frequently than the interest rate indices and repricing terms of Agency RMBS backed by ARMs or hybrid ARMs. Accordingly, if short-term interest rates increase, our borrowing costs may increase faster than the interest rates on Agency RMBS backed by ARMs or hybrid ARMs adjust. As a result, in a period of rising interest rates, we could experience a decrease in net income or a net loss.

In most cases, the interest rate indices and repricing terms of Agency RMBS backed by ARMs or hybrid ARMs and our borrowings will not be identical, thereby potentially creating an interest rate mismatch between our investments and our borrowings. While the historical spread between relevant short-term interest rate indices has been relatively stable, there have been periods when the spread between these indices was volatile. During periods of changing interest rates, these interest rate index mismatches could reduce our net income or produce a net loss, and adversely affect the level of our dividends and the market price of our common stock.

In addition, Agency RMBS backed by ARMs or hybrid ARMs will typically be subject to lifetime interest rate caps which limit the amount an interest rate can increase through the maturity of the Agency RMBS. However, our borrowings under repurchase agreements typically will not be subject to similar restrictions. Accordingly, in a period of rapidly increasing interest rates, the interest rates paid on our borrowings could increase without limitation while caps could limit the interest rates on these types of Agency RMBS. This problem is magnified for Agency RMBS backed by ARMs or hybrid ARMs that are not fully indexed. Further, some Agency RMBS backed by ARMs or hybrid ARMs may be subject to periodic payment caps that result in a portion of the interest being deferred and added to the principal outstanding. As a result, we may receive less cash income on these types of Agency RMBS than we need to pay interest on our related borrowings. These factors could reduce our net interest income and cause us to suffer a loss during periods of rising interest rates.

Because we may acquire fixed-rate securities, an increase in interest rates on our borrowings may adversely affect our book value.

Increases in interest rates may negatively affect the market value of our assets. Any fixed-rate securities we invest in generally will be more negatively affected by these increases than adjustable-rate securities. In accordance with accounting rules, we will be required to reduce our book value by the amount of any decrease in the market value of our assets that are classified for accounting purposes as available-for-sale. We will be required to evaluate our assets on a quarterly basis to determine their fair value by using third party bid price indications provided by dealers who make markets in these securities or by third-party pricing services. If the fair value of a security is not available from a dealer or third-party pricing service, we will estimate the fair value of the security using a variety of methods including, but not limited to, discounted cash flow analysis, matrix pricing, option-adjusted spread models and fundamental analysis. Aggregate characteristics taken into consideration include, but are not limited to, type of collateral, index, margin, periodic cap, lifetime cap, underwriting standards, age and delinquency experience. However, the fair value reflects estimates and may not be indicative of the amounts we would receive in a current market exchange. If we determine that an agency security is other-than-temporarily impaired, we would be required to reduce the value of such agency security on our balance sheet by recording an impairment charge in our income statement and our stockholders equity would be correspondingly reduced. Reductions in stockholders equity decrease the amounts we may borrow to purchase additional target assets, which could restrict our ability to increase our net income.

We may experience a decline in the market value of our assets.

A decline in the market value of our assets may require us to recognize an other-than-temporary impairment against such assets under GAAP if we were to determine that, with respect to any assets in unrealized loss positions, we do not have the ability and intent to hold such assets to maturity or for a period of time sufficient to allow for recovery to the amortized cost of such assets. If such a determination were to be made, we would recognize unrealized losses through earnings and write down the amortized cost of such assets to a new cost basis, based on the fair market value of such assets on the date they are considered to be other-than-temporarily impaired. Such impairment charges reflect non-cash losses at the time of recognition; subsequent disposition or sale of such assets could further affect our future losses or gains, as they are based on the difference between the sale price received and adjusted amortized cost of such assets at the time of sale.

Some of our portfolio investments will be recorded at fair value and, as a result, there will be uncertainty as to the value of these investments.

Some of our portfolio investments will be in the form of securities that are not publicly traded. The fair value of securities and other investments that are not publicly traded may not be readily determinable. We will value these investments quarterly at fair value, as determined in accordance with Statement of Financial Accounting Standards, or SFAS, No. 157, Fair Value Measurements, or SFAS 157, which may include unobservable inputs. Because such valuations are subjective, the fair value of certain of our assets may fluctuate over short periods of time and our determinations of fair value may differ materially from the values that would have been used if a ready market for these securities existed. The value of our common stock

Table of Contents

could be adversely affected if our determinations regarding the fair value of these investments were materially higher than the values that we ultimately realize upon their disposal.

Prepayment rates may adversely affect the value of our investment portfolio.

Pools of residential mortgage loans underlie the RMBS that we will acquire. In the case of residential mortgage loans, there are seldom any restrictions on borrowers abilities to prepay their loans. We will generally receive payments from principal payments that are made on these underlying mortgage loans. When borrowers prepay their mortgage loans faster than expected, this results in prepayments that are faster than expected on the RMBS. Faster than expected prepayments could adversely affect our profitability, including in the following ways:

We may purchase RMBS that have a higher interest rate than the market interest rate at the time. In exchange for this higher interest rate, we may pay a premium over the par value to acquire the security. In accordance with GAAP, we may amortize this premium over the estimated term of the RMBS. If the RMBS is prepaid in whole or in part prior to its maturity date, however, we may be required to expense the premium that was prepaid at the time of the prepayment.

We anticipate that a substantial portion of our adjustable-rate RMBS may bear interest rates that are lower than their fully indexed rates, which are equivalent to the applicable index rate plus a margin. If an adjustable-rate RMBS is prepaid prior to or soon after the time of adjustment to a fully-indexed rate, we will have held that RMBS while it was least profitable and lost the opportunity to receive interest at the fully indexed rate over the remainder of its expected life.

If we are unable to acquire new RMBS similar to the prepaid RMBS, our financial condition, results of operation and cash flow would suffer. Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by conditions in the housing and financial markets, general economic conditions and the relative interest rates on fixed rate mortgage loans, or FRMs, and ARMs.

While we will seek to minimize prepayment risk to the extent practical, in selecting investments we must balance prepayment risk against other risks and the potential returns of each investment. No strategy can completely insulate us from prepayment risk.

Recent market conditions may upset the historical relationship between interest rate changes and prepayment trends, which would make it more difficult for us to analyze our investment portfolio.

Our success depends on our ability to analyze the relationship of changing interest rates on prepayments of the mortgage loans that underlie our RMBS and mortgage loans we acquire. Changes in interest rates and prepayments affect the market price of the target assets that we intend to purchase and any target assets that we hold at a given time. As part of our overall portfolio risk management, we will analyze interest rate changes and prepayment trends separately and collectively to assess their effects on our investment portfolio. In conducting our analysis, we will depend on certain assumptions based upon historical trends with respect to the relationship between interest rates and prepayments under normal market conditions. If the recent dislocations in the mortgage market or other developments change the way that prepayment trends have historically responded to interest rate changes, our ability to (1) assess the market value of our investment portfolio, (2) implement our hedging strategies and (3) implement techniques to reduce our prepayment rate volatility would be significantly affected, which could materially adversely affect our financial position and results of operations.

Mortgage loan modification programs and future legislative action may adversely affect the value of, and the returns on, the target assets in which we intend to invest.

The U.S. Government, through the Federal Reserve, the FHA and the FDIC, commenced implementation of programs designed to provide homeowners with assistance in avoiding residential or commercial mortgage loan foreclosures. The programs may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans or the rate of interest payable on the loans, or to extend the payment terms of the loans. In addition, members of Congress have indicated support for additional legislative relief for homeowners, including an amendment of the bankruptcy laws to permit the modification of mortgage loans in bankruptcy proceedings. The servicer will have the authority to modify mortgage loans that are in default, or for which default is reasonably foreseeable, if such modifications are in the best interests of the holders of the mortgage securities and such modifications are done in accordance with the terms of the relevant agreements. Loan modifications are more likely to be used when borrowers are less able to refinance or sell their homes due to market conditions, and when the potential recovery from a foreclosure is reduced due to lower property values. A significant number of loan modifications could result in a significant reduction in cash flows to the holders of the mortgage securities on an ongoing basis. These loan modification programs, as well as future legislative or regulatory actions, including amendments to the bankruptcy laws, that result in the modification of outstanding mortgage loans may adversely affect the value of, and the returns on, the target assets in which we intend to invest.

Risks Related to Our Common Stock

There is no public market for our common stock and a market may never develop, which could result in holders of our common stock being unable to monetize their investment.

Our shares of common stock are newly-issued securities for which there is no established trading market. Our common stock has been approved for listing on the NYSE subject to official notice of issuance, but there can be no assurance that an active trading market for our common stock will develop. Accordingly, no assurance can be given as to the ability of our stockholders to sell their common stock or the price that our stockholders may obtain for their common stock.

Some of the factors that could negatively affect the market price of our common stock include:

- our actual or anticipated variations in our quarterly operating results;
- changes in our earnings estimates or publication of research reports about us or the real estate industry;
- changes in market valuations of similar companies;
- adverse market reaction to any increased indebtedness we incur in the future;
- additions to or departures of our Manager s key personnel;
- actions by our stockholders; and
- speculation in the press or investment community.

Market factors unrelated to our performance could also negatively impact the market price of our common stock. One of the factors that investors may consider in deciding whether to buy or sell our common stock is our distribution rate as a percentage of our stock price relative to market interest rates. If market interest rates increase, prospective investors may demand a higher distribution rate or seek alternative investments paying higher dividends or interest. As a result, interest rate fluctuations and conditions in the capital markets can affect the market value of our common stock. For instance, if interest rates rise, it is likely that the market price of our common stock will decrease as market rates on interest-bearing securities increase.

Common stock eligible for future sale may have adverse effects on our share price.

We are offering 8,500,000 shares of our common stock as described in this prospectus. In addition, concurrently with the completion of this offering, we will complete a private placement in which we will sell 75,000 shares of our common stock to Invesco, through our Manager at $20.00 per share and 1,425,000 OP units to Invesco, through Invesco Investments (Bermuda) Ltd., at $20.00 per unit. Upon completion of this offering and the concurrent private placement, Invesco, through our Manager, will beneficially own 0.87% of our common stock (or 0.76% if the underwriters fully exercise their option to purchase additional shares). Assuming that all OP units are redeemed for an equivalent number of shares of our common stock, Invesco,

48

through the Invesco Purchaser, would beneficially own 15% of our outstanding common stock upon completion of this offering and the concurrent private placement (or 13.3% if the underwriters fully exercise their option to purchase additional shares). Our equity incentive plan provides for grants of restricted common stock and other equity-based awards up to an aggregate of 6% of the issued and outstanding shares of our common stock (on a fully diluted basis) at the time of the award, subject to a ceiling of 40 million shares of our common stock.

We, our Manager, each of our executive officers and directors and each officer of our Manager have agreed with the underwriters to a 180 day lock-up period (subject to extension in certain circumstances), meaning that, until the end of the 180 day lock-up period, we and they will not, subject to certain exceptions, sell or transfer any shares of common stock without the prior consent of Credit Suisse Securities (USA) LLC and Morgan Stanley & Co. Incorporated, the representatives of the underwriters. Each of our Manager and Invesco Investments (Bermuda) Ltd. will agree that, for a period of one year after the date of this prospectus, it will not, without the prior written consent of Credit Suisse Securities (USA) LLC and Morgan Stanley & Co. Incorporated, dispose of or hedge any of the shares of our common stock or OP units, respectively, that it purchases in the concurrent private placement, subject to extension in certain circumstances. The representatives of the underwriters may, in their sole discretion, at any time from time to time and without notice, waive the terms and conditions of the lock-up agreements to which they are a party. Additionally, each of our Manager and Invesco Investments (Bermuda) Ltd. has agreed with us to a further lock-up period that will expire at the earlier of (i) the date which is one year following the date of this prospectus or (ii) the termination of the management agreement. Assuming no exercise of the underwriters over-allotment option to purchase additional shares, approximately 0.87% of our shares of common stock are subject to lock-up agreements. When the lock-up periods expire, these shares of common stock will become eligible for sale, in some cases subject to the requirements of Rule 144 under the Securities Act of 1933, as amended (or the Securities Act), which are described under Shares Eligible for Future Sale.

We cannot predict the effect, if any, of future sales of our common stock, or the availability of shares for future sales, on the market price of our common stock. The market price of our common stock may decline significantly when the restrictions on resale by certain of our stockholders lapse. Sales of substantial amounts of common stock or the perception that such sales could occur may adversely affect the prevailing market price for our common stock.

Also, we may issue additional shares in subsequent public offerings or private placements to make new investments or for other purposes. We are not required to offer any such shares to existing stockholders on a preemptive basis. Therefore, it may not be possible for existing stockholders to participate in such future share issuances, which may dilute the existing stockholders interests in us.

We have not established a minimum distribution payment level and we cannot assure you of our ability to pay distributions in the future.

We intend to pay quarterly distributions and to make distributions to our stockholders in an amount such that we distribute all or substantially all of our REIT taxable income in each year, subject to certain adjustments. We have not established a minimum distribution payment level and our ability to pay distributions may be adversely affected by a number of factors, including the risk factors described in this prospectus. All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, debt covenants, maintenance of our REIT qualification and other factors as our board of directors may deem relevant from time to time. We believe that a change in any one of the following factors could adversely affect our results of operations and impair our ability to pay distributions to our stockholders:

- the profitability of the investment of the net proceeds of this offering;
- our ability to make profitable investments;

margin calls or other expenses that reduce our cash flow;

defaults in our asset portfolio or decreases in the value of our portfolio; and the fact that anticipated operating expense levels may not prove accurate, as actual results may vary from estimates.

We cannot assure you that we will achieve investment results that will allow us to make a specified level of cash distributions or year-to-year increases in cash distributions in the future. In addition, some of our distributions may include a return in capital.

Investing in our common stock may involve a high degree of risk.

The investments we make in accordance with our investment objectives may result in a high amount of risk when compared to alternative investment options and volatility or loss of principal. Our investments may be highly speculative and aggressive, and therefore an investment in our common stock may not be suitable for someone with lower risk tolerance.

Future offerings of debt or equity securities, which would rank senior to our common stock, may adversely affect the market price of our common stock.

If we decide to issue debt or equity securities in the future, which would rank senior to our common stock, it is likely that they will be governed by an indenture or other instrument containing covenants restricting our operating flexibility. Additionally, any convertible or exchangeable securities that we issue in the future may have rights, preferences and privileges more favorable than those of our common stock and may result in dilution to owners of our common stock. We and, indirectly, our stockholders, will bear the cost of issuing and servicing such securities. Because our decision to issue debt or equity securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus holders of our common stock will bear the risk of our future offerings reducing the market price of our common stock and diluting the value of their stock holdings in us.

Risks Related to Our Organization and Structure

Certain provisions of Maryland law could inhibit changes in control.

Certain provisions of the Maryland General Corporation Law, or the MGCL, may have the effect of deterring a third party from making a proposal to acquire us or of impeding a change in control under circumstances that otherwise could provide the holders of our common stock with the opportunity to realize a premium over the then-prevailing market price of our common stock. We are subject to the business combination provisions of the MGCL that, subject to limitations, prohibit certain business combinations (including a merger, consolidation, share exchange, or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities) between us and an interested stockholder (defined generally as any person who beneficially owns 10% or more of our then outstanding voting capital stock or an affiliate or associate of ours who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of our then outstanding voting capital stock) or an affiliate thereof for five years after the most recent date on which the stockholder becomes an interested stockholder. After the five-year prohibition, any business combination between us and an interested stockholder generally must be recommended by our board of directors and approved by the affirmative vote of at least (1) 80% of the votes entitled to be cast by holders of outstanding shares of our voting capital stock; and (2) two-thirds of the votes entitled to be cast by holders of voting capital stock of the corporation other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested stockholder. These super-majority vote requirements do not apply if our common stockholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares. These provisions of the MGCL do not apply, however, to business combinations that are approved or exempted by a board of directors prior to the time that the interested stockholder becomes an interested stockholder. Pursuant to the statute, our board of directors has by resolution exempted business combinations between us and any other person, provided that such business combination is first approved by our board of directors (including a majority of our directors who are not affiliates or associates of such person).

The control share provisions of the MGCL provide that control shares of a Maryland corporation (defined as shares which, when aggregated with other shares controlled by the stockholder (except solely by virtue of a revocable proxy), entitle the stockholder to exercise one of three increasing ranges of voting power in electing directors) acquired in a control share acquisition (defined as the direct or indirect acquisition of ownership or control of control shares) have no voting rights except to the extent approved by our stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding votes entitled to be cast by the acquiror of control shares, our officers and our personnel who are also our directors. Our Bylaws contain a provision exempting from the control share acquisition statute any and all acquisitions by any person of shares of our stock. There can be no assurance that this provision will not be amended or eliminated at any time in the future.

The unsolicited takeover provisions of the MGCL permit our board of directors, without stockholder approval and regardless of what is currently provided in our charter or Bylaws, to implement takeover defenses, some of which (for example, a classified board) we do not yet have. These provisions may have the effect of inhibiting a third party from making an acquisition proposal for us or of delaying, deferring or preventing a change in control of us under the circumstances that otherwise could provide the holders of shares of common stock with the opportunity to realize a premium over the then current market price. Our charter contains a provision whereby we have elected to be subject to the provisions of Title 3, Subtitle 8 of the MGCL relating to the filling of vacancies on our board of directors. See Certain Provisions of The Maryland General Corporation Law and Our Charter and Bylaws Business Combinations and Certain Provisions of The Maryland General Corporation Law and Our Charter and Bylaws Control Share Acquisitions.

Our authorized but unissued shares of common and preferred stock may prevent a change in our control.

Our charter authorizes us to issue additional authorized but unissued shares of common or preferred stock. In addition, our board of directors may, without stockholder approval, amend our charter to increase the aggregate number of our shares of stock or the number of shares of stock of any class or series that we have authority to issue and classify or reclassify any unissued shares of common or preferred stock and set the preferences, rights and other terms of the classified or reclassified shares. As a result, our board of directors may establish a series of shares of common or preferred stock that could delay or prevent a transaction or a change in control that might involve a premium price for our shares of common stock or otherwise be in the best interest of our stockholders.

We are the sole general partner of our operating partnership and could become liable for the debts and other obligations of our operating partnership beyond the amount of our initial expenditure.

We are the sole general partner of our operating partnership, IAS Operating Partnership LP. As the sole general partner, we are liable for our operating partnership s debts and other obligations. Therefore, if our operating partnership is unable to pay its debts and other obligations, we will be liable for such debts and other obligations beyond the amount of our expenditure for ownership interests in our operating partnership. These obligations could include unforeseen contingent liabilities and could materially adversely affect our financial condition, operating results and ability to make distributions to our stockholders.

Ownership limitations may restrict change of control of business combination opportunities in which our stockholders might receive a premium for their shares.

In order for us to qualify as a REIT for each taxable year after 2008, no more than 50% in value of our outstanding capital stock may be owned, directly or indirectly, by five or fewer individuals during the last half of any calendar year. Individuals for this purpose include natural persons, private foundations, some employee benefit plans and trusts, and some charitable trusts. To preserve our REIT qualification, our charter generally prohibits any person from directly or indirectly owning more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our capital stock or more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our common stock. This ownership limitation could have the effect of discouraging a takeover or other transaction in which holders of our common stock might receive a premium for their shares over the then prevailing market price or which holders might believe to be otherwise in their best interests. Different ownership limits will apply to Invesco. These ownership limits, which our board of directors has determined will not jeopardize our REIT qualification, will allow Invesco to hold up to 25% (by value or by number of shares, whichever is more restrictive) of our common stock or up to 25% (by value or by number of shares, whichever is more restrictive) of our outstanding capital stock.

Tax Risks

Your investment has various U.S. federal income tax risks.

This summary of certain tax risks is limited to the U.S. federal tax risks addressed below. Additional risks or issues may exist that are not addressed in this prospectus and that could affect the U.S. federal income tax treatment of us or our stockholders.

We strongly urge you to review carefully the discussion under U.S. Federal Income Tax Considerations and to seek advice based on your particular circumstances from an independent tax advisor concerning the effects of U.S. federal, state and local income tax law on an investment in our common stock and on your individual tax situation.

Our failure to qualify as a REIT would subject us to U.S. federal income tax and potentially increased state and local taxes, which would reduce the amount of cash available for distribution to our stockholders.

We have been organized and we intend to operate in a manner that will enable us to qualify as a REIT for U.S. federal income tax purposes commencing with our taxable year ending December 31, 2009. We have not requested and do not intend to request a ruling from the Internal Revenue Service, or the IRS, that we qualify as a REIT. The U.S. federal income tax laws governing REITs are complex. The complexity of these provisions and of the applicable U.S. Treasury Department regulations that have been promulgated under the Internal Revenue Code, or Treasury Regulations, is greater in the case of a REIT that, like us, holds its assets through a partnership, and judicial and administrative interpretations of the U.S. federal income tax laws governing REIT qualification are limited. To qualify as a REIT, we must meet, on an ongoing basis, various tests regarding the nature of our assets and our income, the ownership of our outstanding shares, and the amount of our distributions. Moreover, new legislation, court decisions or administrative guidance, in each case possibly with retroactive effect, may make it more difficult or impossible for us to qualify as a REIT. Thus, while we intend to operate so that we will qualify as a REIT, given the highly complex nature of the rules governing REITs, the ongoing importance of factual determinations, and the possibility of future changes in our circumstances, no assurance can be given that we will so qualify for any particular year. These considerations also might restrict the types of assets that we can acquire in the future.

If we fail to qualify as a REIT in any taxable year, and we do not qualify for certain statutory relief provisions, we would be required to pay U.S. federal income tax on our taxable income, and distributions to our stockholders would not be deductible by us in determining our taxable income. In such a case, we might need to borrow money or sell assets in order to pay our taxes. Our payment of income tax would decrease the amount of our income available for distribution to our stockholders. Furthermore, if we fail to maintain our qualification as a REIT, we no longer would be required to distribute substantially all of our net taxable income to our stockholders. In addition, unless we were eligible for certain statutory relief provisions, we could not re-elect to qualify as a REIT until the fifth calendar year following the year in which we failed to qualify.

Complying with REIT requirements may cause us to forego otherwise attractive investment opportunities or financing or hedging strategies.

To qualify as a REIT for U.S. federal income tax purposes, we must continually satisfy various tests regarding the sources of our income, the nature and diversification of our assets, the amounts we distribute to our stockholders and the ownership of our stock. To meet these tests, we may be required to forego investments we might otherwise make. We may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution. Thus, compliance with the REIT requirements may hinder our investment performance.

Complying with REIT requirements may force us to liquidate otherwise attractive investments.

To qualify as a REIT, we generally must ensure that at the end of each calendar quarter at least 75% of the value of our total assets consists of cash, cash items, government securities and qualified REIT real estate assets, including certain mortgage loans and MBS. The remainder of our investment in securities (other than government securities and qualifying real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than government securities and qualifying real estate assets) can consist of the securities of any one issuer, and no more than 25% of the value of our total securities can be represented by securities of one or more TRSs. See U.S. Federal Income Tax Considerations Asset Tests. If we fail to comply with these requirements at the end of any quarter, we must correct the failure within 30 days after the end of such calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate from our portfolio otherwise attractive investments. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.

Potential characterization of distributions or gain on sale may be treated as unrelated business taxable income to tax exempt investors.

If (1) all or a portion of our assets are subject to the rules relating to taxable mortgage pools, (2) we are a pension held REIT, (3) a tax exempt stockholder has incurred debt to purchase or hold our common stock, or (4) the residual REMIC interests we buy generate excess inclusion income, then a portion of the distributions to and, in the case of a stockholder described in clause (3), gains realized on the sale of common stock by such tax exempt stockholder may be subject to federal income tax as unrelated business taxable income under the Internal Revenue Code.

REIT distribution requirements could adversely affect our ability to execute our business plan and may require us to incur debt, sell assets or take other actions to make such distributions.

To qualify as a REIT, we must distribute to our stockholders each calendar year at least 90% of our REIT taxable income (including certain items of non-cash income), determined without regard to the deduction for dividends paid and excluding net capital gain. To the extent that we satisfy the 90% distribution requirement, but distribute less than 100% of our taxable income, we will be subject to U.S. federal corporate income tax on our undistributed income. In addition, we will incur a 4% nondeductible excise tax on the amount, if any, by which our distributions in any calendar year are less than a minimum amount specified under U.S. federal income tax laws. We intend to distribute our net taxable income to our stockholders in a manner intended to satisfy the 90% distribution requirement and to avoid both corporate income tax and the 4% nondeductible excise tax.

Our taxable income may substantially exceed our net income as determined based on GAAP, or differences in timing between the recognition of taxable income and the actual receipt of cash may occur. For example, we may invest in assets, including debt instruments requiring us to accrue original issue discount, or OID, or recognize market discount income, that generates taxable income in excess of economic income or in advance of the corresponding cash flow from the assets referred to as phantom income. We may also acquire distressed debt investments that are subsequently modified by agreement with the borrower either directly or pursuant to our involvement in programs recently announced by the federal government. If amendments to the outstanding debt are significant modifications under applicable Treasury Regulations, the modified debt may be considered to have been reissued to us in a debt-for-debt exchange with the borrower, with gain recognized by us to the extent that the principal amount of the modified debt exceeds our cost of purchasing it prior to modification. Finally, we may be required under the terms of the indebtedness that we incur, whether to private lenders or pursuant to government programs, to use cash received from interest payments to make principal payment on that indebtedness, with the effect that we will recognize income but will not have a corresponding amount of cash available for distribution to our shareholders.

As a result of the foregoing, we may generate less cash flow than taxable income in a particular year and find it difficult or impossible to meet the REIT distribution requirements in certain circumstances. In such circumstances, we may be required to (1) sell assets in adverse market conditions, (2) borrow on unfavorable terms, (3) distribute amounts that would otherwise be invested in future acquisitions, capital expenditures or repayment of debt, or (4) make a taxable distribution of our shares of common stock as part of a distribution in which stockholders may elect to receive shares of common stock or (subject to a limit measured as a percentage of the total distribution) cash, in order to comply with the REIT distribution requirements. Thus, compliance with the REIT distribution requirements may hinder our ability to grow, which could adversely affect the value of our common stock.

We may choose to pay dividends in our own stock, in which case our stockholders may be required to pay income taxes in excess of the cash dividends received.

We may distribute taxable dividends that are payable in cash and shares of our common stock at the election of each stockholder. Under IRS Revenue Procedure 2009-15, up to 90% of any such taxable dividend for 2009 could be payable in our stock. Taxable stockholders receiving such dividends will be required to include the full amount of the dividend as ordinary income to the extent of our current and accumulated earnings and profits for federal income tax purposes. As a result, a U.S. stockholder may be required to pay income taxes with respect to such dividends in excess of the cash dividends received. If a U.S. stockholder sells the stock it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our stock at the time of the sale. Furthermore, with respect to non-U.S. stockholders, we may be required to withhold U.S. tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in stock. In addition, if a significant number of our stockholders determine to sell shares of our common stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our common stock.

Our ownership of and relationship with any TRS which we may form or acquire following the completion of this offering will be limited, and a failure to comply with the limits would jeopardize our REIT qualification and may result in the application of a 100% excise tax.

A REIT may own up to 100% of the stock of one or more TRSs. A TRS may earn income that would not be qualifying income if earned directly by the parent REIT. Both the subsidiary and the REIT must jointly elect to treat the subsidiary as a TRS. Overall, no more than 25% of the value of a REIT s assets may consist of stock or securities of one or more TRSs. A TRS will pay federal, state and local income tax at regular corporate rates on any income that it earns. In addition, the TRS rules impose a 100% excise tax on certain transactions between a TRS and its parent REIT that are not conducted on an arm s length basis.

Any TRS that we may form following the completion of this offering would pay U.S. federal, state and local income tax on its taxable income, and its after tax net income would be available for distribution to us but would not be required to be distributed to us. We anticipate that the aggregate value of the TRS stock and securities owned by us will be less than 25% of the value of our total assets (including the TRS stock and securities). Furthermore, we will monitor the value of our investments in our TRSs to ensure compliance with the rule that no more than 25% of the value of our assets may consist of TRS stock and securities (which is applied at the end of each calendar quarter). In addition, we will scrutinize all of our transactions with TRSs to ensure that they are entered into on arm s length terms to avoid incurring the 100% excise tax described above. There can be no assurance, however, that we will be able to comply with the TRS limitations or to avoid application of the 100% excise tax discussed above.

Liquidation of our assets may jeopardize our REIT qualification.

To qualify as a REIT, we must comply with requirements regarding our assets and our sources of income. If we are compelled to liquidate our investments to repay obligations to our lenders, we may be unable to comply with these requirements, ultimately jeopardizing our qualification as a REIT, or we may be subject to a 100% tax on any resultant gain if we sell assets in transactions that are considered to be prohibited transactions.

Characterization of the repurchase agreements we enter into to finance our investments as sales for tax purposes rather than as secured lending transactions or the failure of a mezzanine loan to qualify as a real estate asset would adversely affect our ability to qualify as a REIT.

We anticipate entering into repurchase agreements with a variety of counterparties to achieve our desired amount of leverage for the assets in which we intend to invest. When we enter into a repurchase agreement, we generally sell assets to our counterparty to the agreement and receive cash from the counterparty. The counterparty is obligated to resell the assets back to us at the end of the term of the transaction. We believe that for U.S. federal income tax purposes we will be treated as the owner of the assets that are the subject of repurchase agreements and that the repurchase agreements will be treated as secured lending transactions notwithstanding that such agreements may transfer record ownership of the assets to the counterparty during the term of the agreement. It is possible, however, that the IRS could successfully assert that we did not own these assets during the term of the repurchase agreements, in which case we could fail to qualify as a REIT.

In addition, we may acquire mezzanine loans, which are loans secured by equity interests in a partnership or limited liability company that directly or indirectly owns real property. In Revenue Procedure 2003-65, the IRS provided a safe harbor pursuant to which a mezzanine loan, if it meets each of the requirements contained in the Revenue Procedure, will be treated by the IRS as a real estate asset for purposes of the REIT asset tests, and interest derived from the mezzanine loan will be treated as qualifying mortgage interest for purposes of the REIT 75% income test. Although the Revenue Procedure provides a safe harbor on which taxpayers may rely, it does not prescribe rules of substantive tax law. We may acquire mezzanine loans that may not meet all of the requirements for reliance on this safe harbor. In the event we own a mezzanine loan that does not meet the safe harbor, the IRS could challenge such loan s treatment as a real estate asset for purposes of the REIT asset and income tests, and if such a challenge were sustained, we could fail to qualify as a REIT.

Complying with REIT requirements may limit our ability to hedge effectively.

The REIT provisions of the Internal Revenue Code limit our ability to hedge MBS and related borrowings. Under these provisions, our annual gross income from non-qualifying hedges, together with any other income not generated from qualifying real estate assets, cannot exceed 25% of our gross income (excluding for this purpose, gross income from qualified hedges). In addition, our aggregate gross income from non-qualifying hedges, fees, and certain other non qualifying sources cannot exceed 5% of our annual gross income. As a result, we might have to limit our use of advantageous hedging techniques or implement those hedges through a TRS, which we may form following the completion of this offering. This could increase the cost of our hedging activities or expose us to greater risks associated with changes in interest rates than we would otherwise want to bear.

Even if we qualify as a REIT, we may face tax liabilities that reduce our cash flow.

Even if we qualify as a REIT, we may be subject to certain U.S. federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, franchise, property and transfer taxes, including mortgage related taxes. See U.S. Federal Income Tax Considerations Taxation of REITs in General. In addition, any

Table of Contents

TRSs we own will be subject to U.S. federal, state, and local corporate taxes. In order to meet the REIT qualification requirements, or to avoid the imposition of a 100% tax that applies to certain gains derived by a REIT from sales of inventory or property held primarily for sale to customers in the ordinary course of business, we may hold some of our assets through taxable subsidiary corporations, including TRSs. Any taxes paid by such subsidiary corporations would decrease the cash available for distribution to our stockholders.

We may be subject to adverse legislative or regulatory tax changes that could reduce the market price of our common stock.

At any time, the U.S. federal income tax laws or regulations governing REITs or the administrative interpretations of those laws or regulations may be amended. We cannot predict when or if any new U.S. federal income tax law, regulation or administrative interpretation, or any amendment to any existing federal income tax law, regulation or administrative interpretation, will be adopted, promulgated or become effective and any such law, regulation or interpretation may take effect retroactively. We and our stockholders could be adversely affected by any such change in, or any new, federal income tax law, regulation or administrative interpretation.

Dividends payable by REITs do not qualify for the reduced tax rates.

Legislation enacted in 2003 generally reduces the maximum tax rate for dividends payable to domestic stockholders that are individuals, trusts and estates from 38.6% to 15% (through 2010). Dividends payable by REITs, however, are generally not eligible for the reduced rates. Although this legislation does not adversely affect the taxation of REITs or dividends paid by REITs, the more favorable rates applicable to regular corporate dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in stock of non REIT corporations that pay dividends, which could adversely affect the value of the stock of REITs, including our common stock.

Table of Contents

FORWARD-LOOKING STATEMENTS

We make forward-looking statements in this prospectus that are subject to risks and uncertainties. These forward-looking statements include information about possible or assumed future results of our business, financial condition, liquidity, results of operations, plans and objectives. When we use the words believe, expect, anticipate, estimate, plan, continue, intend, should, may or similar expressions, we intend to identify forward-looking sta Statements regarding the following subjects, among others, may be forward-looking:

- use of proceeds of this offering;
- our business and investment strategy;
- our projected operating results;
- actions and initiatives of the U.S. Government and changes to U.S. Government policies;
- our ability to obtain financing arrangements;
- financing and advance rates for our target assets;
- our expected leverage;
- general volatility of the securities markets in which we invest;
- our expected investments;
- interest rate mismatches between our target assets and our borrowings used to fund such investments;
- changes in interest rates and the market value of our target assets;
- changes in prepayment rates on our target assets;
- effects of hedging instruments on our target assets;
- rates of default or decreased recovery rates on our target assets;
- the degree to which our hedging strategies may or may not protect us from interest rate volatility;
- changes in governmental regulations, tax law and rates, and similar matters;
- our ability to maintain our qualification as a REIT for U.S. federal income tax purposes;
- our ability to maintain our exemption from registration under the 1940 Act;
- availability of investment opportunities in mortgage-related, real estate-related and other securities;
- availability of qualified personnel;

- estimates relating to our ability to make distributions to our stockholders in the future;

- our understanding of our competition; and

- market trends in our industry, interest rates, real estate values, the debt securities markets or the general economy.

The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. You should not place undue reliance on these forward-looking statements. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us. Some of these factors are described in this prospectus under the headings Summary, Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations and Business. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made. New risks and uncertainties arise over time, and it is not possible for us to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Table of Contents

USE OF PROCEEDS

We are offering 8,500,000 shares of our common stock at the anticipated public offering price of $20.00 per share. Concurrently with the completion of this offering, we will complete a private placement in which we will sell 75,000 shares of our common stock to Invesco, through our Manager, at $20.00 per share and 1,425,000 units of limited partnership interest in our operating partnership to Invesco, through Invesco Investments (Bermuda) Ltd., at $20.00 per unit. We estimate that the net proceeds we will receive from selling common stock in this offering will be approximately $165.6 million, after deducting the portion of the assumed underwriting discounts and commissions payable by us and estimated offering expenses of approximately $4.4 million (or, if the underwriters exercise their over-allotment option in full, approximately $190.7 million, after deducting the portion of the assumed underwriting discounts and commissions payable by us and estimated offering expenses of approximately $4.8 million). We estimate that the net proceeds we will receive in the concurrent private placement of our common stock and OP units will be approximately $30 million.

We plan to use all the net proceeds from this offering and the concurrent private placement as described above to acquire our target assets in accordance with our objectives and strategies described in this prospectus. See Business Our Investment Strategy. We expect that our focus will be on purchasing Agency RMBS, non-Agency RMBS, CMBS and certain mortgage loans, subject to our investment guidelines and to the extent consistent with maintaining our REIT qualification. Our Manager will make determinations as to the percentage of our assets that will be invested in each of our target assets. Based on prevailing market conditions, our current expectation is that our initial investment portfolio will consist of between 45% to 55% non-Agency RMBS, 10% to 15% CMBS and the balance in Agency RMBS. However, there is no assurance that upon the completion of this offering we will not allocate the proceeds from this offering and concurrent private placement in a different manner among our target assets. Our decisions will depend on prevailing market conditions and may change over time in response to opportunities available in different interest rate, economic and credit environments. Until appropriate assets can be identified, our Manager may invest the net proceeds from this offering and the concurrent private placement in interest-bearing short-term investments, including money market accounts, that are consistent with our intention to qualify as a REIT. These investments are expected to provide a lower net return than we will seek to achieve from our target assets. Prior to the time we have fully used the net proceeds of this offering and the concurrent private placement to acquire our target assets, we may fund our quarterly distributions out of such net proceeds.

DISTRIBUTION POLICY

We intend to make regular quarterly distributions to holders of our common stock. U.S. federal income tax law generally requires that a REIT distribute annually at least 90% of its REIT taxable income, without regard to the deduction for dividends paid and excluding net capital gains, and that it pay tax at regular corporate rates to the extent that it annually distributes less than 100% of its net taxable income. We generally intend over time to pay quarterly dividends in an amount equal to our net taxable income. We plan to pay our first dividend in respect of the period from the closing of this offering through September 30, 2009, which may be prior to the time when we have fully invested the net proceeds from this offering in our target assets.

To the extent that in respect of any calendar year, cash available for distribution is less than our net taxable income, we could be required to sell assets or borrow funds to make cash distributions or make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities. In addition, prior to the time we have fully invested the net proceeds of this offering, we may fund our quarterly distributions out of such net proceeds. We will generally not be required to make distributions with respect to activities conducted through any TRS that we form following the completion of this offering. For more information, see U.S. Federal Income Tax Considerations Taxation of Our Company in General.

To satisfy the requirements to qualify as a REIT and generally not be subject to U.S. federal income and excise tax, we intend to make regular quarterly distributions of all or substantially all of our net taxable income to holders of our common stock out of assets legally available therefor. Any distributions we make will be at the discretion of our board of directors and will depend upon our earnings and financial condition, debt covenants, funding or margin requirements under repurchase agreements, warehouse facilities or other secured and unsecured borrowing agreements, maintenance of our REIT qualification, applicable provisions of the MGCL, and such other factors as our board of directors deems relevant. Our earnings and financial condition will be affected by various factors, including the net interest and other income from our portfolio, our operating expenses and any other expenditures. For more information regarding risk factors that could materially adversely affect our earnings and financial condition, see Risk Factors.

We anticipate that our distributions generally will be taxable as ordinary income to our stockholders, although a portion of the distributions may be designated by us as qualified dividend income or capital gain, or may constitute a return of capital. We will furnish annually to each of our stockholders a statement setting forth distributions paid during the preceding year and their characterization as ordinary income, return of capital, qualified dividend income or capital gain. For more information, see U.S. Federal Income Tax Considerations Taxation of Taxable U.S. Stockholders.

Table of Contents

CAPITALIZATION

The following table sets forth (1) our actual capitalization at March 31, 2009 and (2) our capitalization as adjusted to reflect the effect of the sale of our common stock in this offering at an assumed offering price of $20.00 per share after deducting the underwriting discount and estimated organizational and offering expenses payable by us and the concurrent private placement to the Invesco Purchaser of 75,000 shares of our common stock and 1,425,000 OP units at the assumed initial public offering price. You should read this table together with Management s Discussion and Analysis of Financial Condition and Results of Operations and Use of Proceeds included elsewhere in this prospectus.

	As of March 31, 2009	
	Actual	As Adjusted[(1)]
	(Unaudited) (Dollars in Thousands)	
Stockholder s equity:		
Common stock, par value $0.01 per share; 100,000 shares authorized, and 100 shares issued and outstanding, actual and 450,000,000 shares authorized and 8,575,100 shares outstanding, as adjusted	$	$ 86
Preferred Stock, par value $0.01 per share; 0 shares authorized and 0 shares issued and outstanding, actual and 50,000,000 shares authorized and 0 shares outstanding, as adjusted		
Additional paid in capital	1	166,965(2)
Accumulated deficit during development stage	(70)	(70)
Total stockholder s (deficiency) equity	$ (69)	$ 166,981
Noncontrolling interests:		
Operating partnership		28,500(3)
Total capitalization	$ (69)	$ 195,481

(1) Does not include the underwriters option to purchase up to 1,275,000 additional shares.

(2) Represents additional paid in capital net of issuance costs.

(3) Represents 1,425,000 OP units issued to Invesco Investments (Bermuda) Ltd. by our operating partnership, at $20.00 per OP unit.

Table of Contents

SELECTED FINANCIAL INFORMATION

The following table presents selected historical financial information as of March 31, 2009 and December 31, 2008, and for the three months ended March 31, 2009 and for the period from June 5, 2008 (date of incorporation) to December 31, 2008. The historical financial information as of December 31, 2008 and for the period from June 5, 2008 (date of incorporation) to December 31, 2008 presented in the table below has been derived from our audited financial statements. The information presented below is not necessarily indicative of the trends in our performance or our results for a full fiscal year.

The information presented below is only a summary and does not provide all of the information contained in our historical financial statements, including the related notes. You should read the information below in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our historical financial statements, including the related notes, included elsewhere in this prospectus.

Balance Sheet Data

	As of March 31, 2009 (Unaudited)	As of December 31, 2008
Assets:		
Cash	$ 1,000	$ 1,000
Other assets deferred offering costs	1,213,582	978,333
Total Assets	$ 1,214,582	$ 979,333
Liabilities and Stockholder s Deficiency:		
Due to affiliate	$ 1,283,909	$ 1,000,714
Stockholder s deficiency	(69,327)	(21,381)
Total Liabilities and Stockholder s Deficiency	$ 1,214,582	$ 979,333

Statement of Income Data

	For the Three Months Ended March 31, 2009 (Unaudited)	For the Period June 5, 2008 (Date of Incorporation) Through December 31, 2008
Revenue	$	$

Expenses:				
Operating Expenses		45,237		
Organizational Costs		2,709		22,381
Net Loss	$	(47,946)	$	(22,381)

Table of Contents

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion in conjunction with the sections of this prospectus entitled Risk Factors, Forward-Looking Statements, Business and our audited balance sheet as of December 31, 2008 and the related notes thereto included elsewhere in this prospectus. This discussion contains forward-looking statements reflecting current expectations that involve risks and uncertainties. Actual results and the timing of events may differ materially from those contained in these forward-looking statements due to a number of factors, including those discussed in the section entitled Risk Factors and elsewhere in this prospectus.

Overview

We are a newly-formed Maryland corporation focused on investing in, financing and managing residential and commercial mortgage-backed securities and mortgage loans. We will seek to invest in Agency RMBS, non-Agency RMBS, CMBS and residential and commercial mortgage loans. We anticipate financing our Agency RMBS through traditional repurchase agreement financing. In addition, to the extent available to us, we may seek to finance our investments in CMBS and non-Agency RMBS with financings under TALF, or with private financing sources. If available, we may also finance our investments in certain CMBS and non-Agency RMBS by contributing capital to one or more of the Legacy Securities PPIFs, that receive financing under PPIP, and our investments in certain legacy commercial and residential mortgage loans by contributing capital to one or more Legacy Loan PPIFs, that receive such funding or through private financing sources. Legacy Securities PPIFs and Legacy Loan PPIFs may be established and managed by our Manager or one of its affiliates or by unaffiliated third parties; however, our Manager or its affiliates may only establish a Legacy Securities PPIF if their application to serve as an investment manager of this type of PPIP fund is accepted by the U.S. Treasury. To the extent we pay any fees to our Manager or any of its affiliates in connection with any PPIF, our Manager has agreed to reduce the management fee payable by us under the management agreement (but not below zero) in respect of any equity investment we may decide to make in any PPIF managed by our Manager or any of its affiliates by the amount of the fees payable to our Manager or its affiliates under the PPIF with regard to our equity investment.

We will be externally managed and advised by our Manager, an SEC-registered investment adviser and indirect wholly owned subsidiary of Invesco. Invesco is a leading independent global investment management company with $348.2 billion in assets under management as of March 31, 2009. Our Manager will draw upon the expertise of Invesco s Worldwide Fixed Income investment team of 114 investment professionals operating in six cities, across four countries, with approximately $157 billion in securities under management and Invesco Real Estate s 219 employees operating in 13 cities across eight countries with over $20 billion in private and public real estate assets under management. With over 25 years of experience, Invesco s teams of dedicated professionals have developed exceptional track records across multiple fixed income sectors and asset classes, including structured securities, such as RMBS, ABS, CMBS, and leveraged loan portfolios. In addition, the investment team will draw upon the mortgage market insights of our Manager s WL Ross subsidiary.

Our objective is to provide attractive risk adjusted returns to our investors over the long term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by selectively acquiring target assets to construct a diversified investment portfolio designed to produce attractive returns across a variety of market conditions and economic cycles. We intend to construct a diversified investment portfolio by focusing on security selection and the relative value of various sectors within the mortgage market. We intend to finance our Agency RMBS investments primarily through short-term borrowings structured as repurchase agreements. To date, we have signed nine master repurchase agreements with nine financial institutions, and we are in discussions with nine additional financial institutions for repurchase facilities. As described in more detail below, to the extent available to us, we may seek to finance our non-Agency RMBS, CMBS and mortgage loan portfolios with attractive non-recourse term borrowing facilities and equity financing under the TALF or with private financing sources and, if available, we may make investments in funds that receive financing under the PPIP that will be established and managed by our

Manager or one of its affiliates if their application to serve as one of the investment managers for the Legacy Securities Program is accepted by the U.S. Treasury.

We will commence operations upon completion of this offering. We intend to elect and qualify to be taxed as a REIT for U.S. federal income tax purposes, commencing with our taxable year ending December 31, 2009. We generally will not be subject to U.S. federal income taxes on our taxable income to the extent that we annually distribute all of our net taxable income to stockholders and maintain our intended qualification as a REIT. We also intend to operate our business in a manner that will permit us to maintain our exemption from registration under the 1940 Act.

Factors Impacting Our Operating Results

We expect that the results of our operations will be affected by a number of factors and primarily depend on, among other things, the level of our net interest income, the market value of our assets and the supply of, and demand for, the target assets in which we intend to invest. Our net interest income, which includes the amortization of purchase premiums and accretion of purchase discounts, varies primarily as a result of changes in market interest rates and prepayment speeds, as measured by the Constant Prepayment Rate, or CPR, on our target assets. Interest rates and prepayment speeds vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty.

Changes in Market Interest Rates

With respect to our proposed business operations, increases in interest rates, in general, may over time cause: (1) the interest expense associated with our borrowings to increase; (2) the value of our investment portfolio to decline; (3) coupons on our ARMs and hybrid ARMs, RMBS, CMBS and mortgage loans mortgage loans to reset, although on a delayed basis, to higher interest rates; (4) prepayments on our RMBS and residential mortgage loans to slow, thereby slowing the amortization of our purchase premiums and the accretion of our purchase discounts; and (5) to the extent we enter into interest rate swap agreements as part of our hedging strategy, the value of these agreements to increase. Conversely, decreases in interest rates, in general, may over time cause: (1) prepayments on our RMBS and residential mortgage loans to increase, thereby accelerating the amortization of our purchase premiums and the accretion of our purchase discounts; (2) the interest expense associated with our borrowings to decrease; (3) the value of our investment portfolio to increase; (4) to the extent we enter into interest rate swap agreements as part of our hedging strategy, the value of these agreements to decrease; and (5) coupons on our adjustable-rate and hybrid Agency RMBS and non-Agency RMBS assets and mortgage loans to reset, although on a delayed basis, to lower interest rates.

Residential Mortgage Loan Prepayment Speeds

Prepayment speeds vary according to interest rates, the type of investment, conditions in the financial markets, competition, foreclosures and other factors, none of which can be predicted with any certainty. We expect that over time our adjustable-rate and hybrid Agency RMBS and non-Agency RMBS will experience higher prepayment rates than do fixed-rate RMBS, as we believe that homeowners with ARMs and hybrid ARMs exhibit more rapid housing turnover levels or refinancing activity compared to fixed-rate borrowers.

Spreads on RMBS

The spread between swap rates and RMBS has recently been volatile. Spreads on non-Treasury, fixed income assets have moved sharply wider due to the difficult credit conditions. The poor collateral performance of the sub-prime mortgage sector coupled with declining home prices have had a negative impact on investor confidence. As the prices of securitized assets have declined, a number of investors and a number of structured investment vehicles have faced margin calls from dealers and have been forced to sell assets in order to reduce leverage. The price volatility of these assets has also impacted lending terms in the repurchase market, as counterparties have raised margin requirements to reflect the more difficult environment. The spread between the yield on our assets and our funding costs is an important factor in the performance of our business. Wider spreads imply greater income on new asset purchases but may have a negative impact on our stated book

Table of Contents

value. Wider spreads may also negatively impact asset prices. In an environment where spreads are widening, counterparties may require additional collateral to secure borrowings which may require us to reduce leverage by selling assets. Conversely, tighter spreads imply lower income on new asset purchases but may have a positive impact on our stated book value. Tighter spreads may have a positive impact on asset prices. In this case we may be able to reduce the amount of collateral required to secure borrowings.

RMBS Extension Risk

Our Manager will compute the projected weighted-average life of our investments based on assumptions regarding the rate at which the borrowers will prepay the underlying mortgages. In general, when we acquire a FRM or hybrid ARM security, 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 assets. 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 RMBS.

However, if prepayment rates decrease in a rising interest rate environment, the life of the fixed-rate portion of the related assets could extend beyond the term of the swap agreement or other hedging instrument. This could have a negative impact on our results of operations, as borrowing costs would no longer be fixed after the end of the hedging instrument while the income earned on the hybrid ARM security would remain fixed. This situation may also cause the market value of our hybrid ARM security 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.

CMBS Real Estate Risk

Commercial property values and net operating income derived from such properties are subject to volatility and may be affected adversely by a number of factors, including, but not limited to: national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors); local2"> (4) (4)

Income Before Provision for Income Taxes

134	134	164	(287)	145

Provision for income taxes

	8			8

Net Income

134	134	156	(287)	137

Less: Net income attributable to noncontrolling interests	3	3			
Net Income Attributable to Partners	$134	$134	$153	$(287)	$134

Comprehensive Income

$134	$134	$139	$(287)	$120

Less: Comprehensive income attributable to noncontrolling interests

	3	3		

Comprehensive Income Attributable to Partners

$134	$134	$136	$(287)	$117

Table of Contents

Condensed Consolidating Statement of Comprehensive Income

Three Months Ended September 30, 2011

(in millions, unaudited)

	Parent Guarantor	Subsidiary Issuer	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Revenues					
Sales and other operating revenue:					
Unaffiliated customers	$	$	$ 2,808	$	$ 2,808
Affiliates			39		39
Other income			3		3
Equity in earnings of subsidiaries	95	119		(214)	
Total Revenues	95	119	2,850	(214)	2,850
Costs and Expenses					
Cost of products sold and operating expenses			2,675		2,675
Depreciation and amortization expense			24		24
Selling, general and administrative expenses			23		23
Total Costs and Expenses			2,722		2,722
Operating Income	95	119	128	(214)	128
Interest cost and debt expense, net		26			26
Capitalized interest		(2)			(2)
Income Before Provision for Income Taxes	95	95	128	(214)	104
Provision for income taxes			7		7
Net Income	95	95	121	(214)	97
Less: Net income attributable to noncontrolling interests			2		2
Net Income Attributable to Partners	$ 95	$ 95	$ 119	$ (214)	$ 95
Comprehensive Income	$ 95	$ 95	$ 132	$ (214)	$ 108
Less: Comprehensive income attributable to noncontrolling interests			2		2
Comprehensive Income Attributable to Partners	$ 95	$ 95	$ 130	$ (214)	$ 106

Condensed Consolidating Statement of Comprehensive Income

Nine Months Ended September 30, 2012

(in millions, unaudited)

	Parent Guarantor	Subsidiary Issuer	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Revenues					
Sales and other operating revenue:					
Unaffiliated customers	$	$	$ 9,460	$	$ 9,460
Affiliates			461		461
Other income			18		18
Gain on divestment and related matters			11		11
Equity in earnings of subsidiaries	381	443		(824)	
Total Revenues	381	443	9,950	(824)	9,950
Costs and Expenses					
Cost of products sold and operating expenses			9,311		9,311
Depreciation and amortization expense			76		76
Impairment charge and related matters			(1)		(1)
Selling, general and administrative expenses			86		86
Total Costs and Expenses			9,472		9,472
Operating Income	381	443	478	(824)	478
Interest cost and debt expense, net		70	3		73
Capitalized interest		(8)			(8)
Income Before Provision for Income Taxes	381	381	475	(824)	413
Provision for income taxes			24		24
Net Income	381	381	451	(824)	389
Less: Net income attributable to noncontrolling interests			8		8
Net Income Attributable to Partners	$ 381	$ 381	$ 443	$ (824)	$ 381
Comprehensive Income	$ 381	$ 381	$ 430	$ (824)	$ 368
Less: Comprehensive income attributable to noncontrolling interests			8		8
Comprehensive Income Attributable to Partners	$ 381	$ 381	$ 422	$ (824)	$ 360

Table of Contents

Condensed Consolidating Statement of Comprehensive Income

Nine Months Ended September 30, 2011

(in millions, unaudited)

	Parent Guarantor	Subsidiary Issuer	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Revenues					
Sales and other operating revenue:					
Unaffiliated customers	$	$	$ 7,148	$	$ 7,148
Affiliates			381		381
Other income			9		9
Equity in earnings of subsidiaries	237	298		(535)	
Total Revenues	237	298	7,538	(535)	7,538
Costs and Expenses					
Cost of products sold and operating expenses			7,086		7,086
Depreciation and amortization expense			61		61
Selling, general and administrative expenses			67		67
Total Costs and Expenses			7,214		7,214
Operating Income	237	298	324	(535)	324
Interest cost and debt expense, net		66	2		68
Capitalized interest		(5)			(5)
Income Before Provision for Income Taxes	237	237	322	(535)	261
Provision for income taxes			18		18
Net Income	237	237	304	(535)	243
Less: Net income attributable to noncontrolling interests			6		6
Net Income Attributable to Partners	$ 237	$ 237	$ 298	$ (535)	$ 237
Comprehensive Income	$ 237	$ 237	$ 316	$ (535)	$ 255
Less: Comprehensive income attributable to noncontrolling interests			6		6
Comprehensive Income Attributable to Partners	$ 237	$ 237	$ 310	$ (535)	$ 249

24

Table of Contents

Condensed Consolidating Balance Sheet

September 30, 2012

(in millions, unaudited)

	Parent Guarantor	Subsidiary Issuer	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Assets					
Cash and cash equivalents	$	$ 2	$	$	$ 2
Advances to affiliated companies	(3)	(26)	67		38
Accounts receivable, affiliated companies			1		1
Accounts receivable, net			1,998		1,998
Inventories			250		250
Total Current Assets	(3)	(24)	2,316		2,289
Properties, plants and equipment, net			2,678		2,678
Investment in affiliates	1,281	2,851	82	(4,132)	82
Goodwill			77		77
Intangible assets, net			258		258
Other assets		12	24		36
Total Assets	$ 1,278	$ 2,839	$ 5,435	$ (4,132)	$ 5,420
Liabilities and Equity					
Accounts payable	$	$	$ 1,980	$	$ 1,980
Accrued liabilities		14	82		96
Accrued taxes payable			56		56
Total Current Liabilities		14	2,118		2,132
Long-term debt		1,544	83		1,627
Other deferred credits and liabilities			61		61
Deferred income taxes			221		221
Total Liabilities		1,558	2,483		4,041
Total Equity	1,278	1,281	2,952	(4,132)	1,379
Total Liabilities and Equity	$ 1,278	$ 2,839	$ 5,435	$ (4,132)	$ 5,420

Table of Contents

Condensed Consolidating Balance Sheet

December 31, 2011

(in millions)

	Parent Guarantor	Subsidiary Issuer	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Assets					
Cash and cash equivalents	$	$ 2	$ 3	$	$ 5
Advances to affiliated companies	90	48	(31)		107
Accounts receivable, net			2,188		2,188
Inventories			206		206
Total Current Assets	90	50	2,366		2,506
Properties, plants and equipment, net			2,522		2,522
Investment in affiliates	1,007	2,680	73	(3,687)	73
Goodwill			77		77
Intangible assets, net			277		277
Other assets		13	9		22
Total Assets	$ 1,097	$ 2,743	$ 5,324	$ (3,687)	$ 5,477
Liabilities and Equity					
Accounts payable	$	$ 1	$ 2,110	$	$ 2,111
Current portion of long-term debt		250			250
Accrued liabilities	1	37	74		112
Accrued taxes payable			62		62
Total Current Liabilities	1	288	2,246		2,535
Long-term debt		1,448			1,448
Other deferred credits and liabilities			78		78
Deferred income taxes			222		222
Total Liabilities	1	1,736	2,546		4,283
Total Equity	1,096	1,007	2,778	(3,687)	1,194
Total Liabilities and Equity	$ 1,097	$ 2,743	$ 5,324	$ (3,687)	$ 5,477

Table of Contents

Condensed Consolidating Statement of Cash Flows

Nine Months Ended September 30, 2012

(in millions, unaudited)

	Parent Guarantor	Subsidiary Issuer	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Net Cash Flows from Operating Activities	$ 381	$ 359	$ 495	$ (824)	$ 411
Cash Flows from Investing Activities:					
Capital expenditures			(235)		(235)
Proceeds from divestments and related matters			11		11
Intercompany	(290)	(279)	(255)	824	
Net cash provided by (used in) investing activities	(290)	(279)	(479)	824	(224)
Cash Flows from Financing Activities:					
Distributions paid to limited and general partners	(178)				(178)
Distributions paid to noncontrolling interests	(5)				(5)
Payments of statutory withholding on net issuance of limited partner units under restricted unit incentive plan			(5)		(5)
Repayments under credit facilities		(322)			(322)
Borrowings under credit facilities		418	83		501
Repayment of senior notes		(250)			(250)
Advances to affiliated companies, net	92	74	(97)		69
Net cash used in financing activities	(91)	(80)	(19)		(190)
Net change in cash and cash equivalents			(3)		(3)
Cash and cash equivalents at beginning of year		2	3		5
Cash and cash equivalents at end of period	$	$ 2	$	$	$ 2

27

Table of Contents

Condensed Consolidating Statement of Cash Flows

Nine Months Ended September 30, 2011

(in millions, unaudited)

	Parent Guarantor	Subsidiary Issuer	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Net Cash Flows from Operating Activities	$ 237	$ 225	$ 288	$ (535)	$ 215
Cash Flows from Investing Activities:					
Capital expenditures			(122)		(122)
Acquisitions			(396)		(396)
Intercompany	(8)	(788)	261	535	
Net cash provided by (used in) investing activities	(8)	(788)	(257)	535	(518)
Cash Flows from Financing Activities:					
Distributions paid to limited and general partners	(156)				(156)
Distributions paid to noncontrolling interests	(3)				(3)
Contributions from general partner	2				2
Payments of statutory withholding on net issuance of limited partner units under restricted unit incentive plan			(3)		(3)
Repayments under credit facilities		(561)			(561)
Borrowings under credit facilities		529			529
Net proceeds from issuance of long-term debt		595			595
Advances to affiliated companies, net	(72)		(22)		(94)
Net cash provided by (used in) financing activities	(229)	563	(25)		309
Net change in cash and cash equivalents			6		6
Cash and cash equivalents at beginning of year		2			2
Cash and cash equivalents at end of period	$	$ 2	$ 6	$	$ 8

Table of Contents

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

The following table presents our consolidated operating results for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Revenues				
Sales and other operating revenue:				
Unaffiliated customers	$ 3,066	$ 2,808	$ 9,460	$ 7,148
Affiliates	141	39	461	381
Other income	11	3	18	9
Gain on divestment and related matters			11	
Total Revenues	3,218	2,850	9,950	7,538
Costs and Expenses				
Cost of products sold and operating expenses	2,997	2,675	9,311	7,086
Depreciation and amortization expense	26	24	76	61
Impairment charge and related matters			(1)	
Selling, general and administrative expenses	30	23	86	67
Total Costs and Expenses	3,053	2,722	9,472	7,214
Operating Income	165	128	478	324
Interest cost and debt expense, net	24	26	73	68
Capitalized interest	(4)	(2)	(8)	(5)
Income Before Provision for Income Taxes	145	104	413	261
Provision for income taxes	8	7	24	18
Net Income	137	97	389	243
Less: Net income attributable to noncontrolling interests	3	2	8	6
Net income Attributable to Partners	$ 134	$ 95	$ 381	$ 237
Net income Attributable to Partners per Limited Partner unit:				
Basic	$ 1.09	$ 0.78	$ 3.15	$ 1.96
Diluted	$ 1.09	$ 0.78	$ 3.14	$ 1.95

Non-GAAP Financial Measures

To supplement our financial information presented in accordance with United States generally accepted accounting principles (GAAP), management uses additional measures that are known as non-GAAP financial measures in its evaluation of past performance and prospects for the future. The primary measures used by management are earnings before interest, taxes, depreciation and amortization expenses and other non-cash items (Adjusted EBITDA) and distributable cash flow (DCF).

Our management believes Adjusted EBITDA and distributable cash flow information enhances an investor s understanding of a business s ability to generate cash for payment of distributions and other purposes. In addition, EBITDA calculations are also defined and used as a measure in determining our compliance with certain revolving credit facility covenants. However, there may be contractual, legal, economic or other reasons which may prevent us from satisfying principal and interest obligations with respect to indebtedness and may require us to allocate funds for other purposes. Adjusted EBITDA and distributable cash flow do not represent and should not be considered alternatives to net income or cash flows from operating activities as determined under GAAP and may not be comparable to other similarly titled measures of other businesses.

The following table reconciles the differences between net income, as determined under GAAP, Adjusted EBITDA and distributable cash flow:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in millions)			
Net Income Attributable to Partners	$ 134	$ 95	$ 381	$ 237
Interest cost, net	20	24	65	63
Depreciation and amortization expense	26	24	76	61
Impairment charge(1)			9	
Provision for income taxes	8	7	24	18
Adjusted EBITDA (2)	$ 188	$ 150	$ 555	$ 379
Interest cost, net	(20)	(24)	(65)	(63)
Maintenance capital expenditures	(11)	(10)	(29)	(20)
Provision for income taxes	(8)	(7)	(24)	(18)
Distributable cash flow	$ 149	$ 109	$ 437	$ 278

The following table reconciles the difference between net cash provided by operating activities and Adjusted EBITDA:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in millions)			
Net cash provided by operating activities	$ 129	$ 220	$ 411	$ 215
Interest cost, net	20	24	65	63
Claim for recovery of environmental liability			14	
Gain on reversal of tank cleaning liability			10	
Net working capital pertaining to operating activities	33	(105)	35	89
Provision for income taxes	8	7	24	18
Net income attributable to noncontrolling interests	(3)	(2)	(8)	(6)
Other	1	6	4	
Adjusted EBITDA (2)	$ 188	$ 150	$ 555	$ 379

(1) In the first quarter 2012, the Partnership recognized a non-cash impairment charge related to a cancelled software project for the crude oil acquisition and marketing business and a refined products pipeline project in Texas.

(2) In the second quarter 2012, the Partnership recognized a $10 million gain on the reversal of certain regulatory obligations. Such expenses were no longer expected to be incurred as the Philadelphia refinery will continue to operate in connection with Sunoco s joint venture with The Carlyle Group. This gain was included in the Partnership s Adjusted EBITDA, which is consistent with prior period presentation.

Table of Contents

Analysis of Consolidated Operating Results

Net income attributable to partners was $134 and $95 million for the three months ended September 30, 2012 and 2011, respectively. Net income attributable to partners for the third quarter 2012 increased $39 million compared to the prior year period. This increase was due primarily to improved operating performance which benefited from strong demand for crude oil transportation services, contributions from our 2011 acquisitions and organic projects and lower interest expense attributable to the repayment of $250 million of Senior Notes and a $100 million promissory note to affiliate. These positive factors were partially offset by higher selling, general and administrative expenses attributable to increased employee costs related to growth in the business.

Net income attributable to partners was $381 and $237 million for the nine months ended September 30, 2012 and 2011, respectively. Net income attributable to partners for the nine months ended September 30, 2012 increased $144 million compared to the prior year period due primarily to improved operating performance which benefited from strong demand for crude oil transportation services and contributions from our 2011 acquisitions and organic projects. Included in current year results were gains of $25 million due to the reversal of regulatory obligations that were recorded in 2011, a contract settlement in connection with the sale of a refined products terminal and pipeline assets and an asset sale by one of the Partnership s joint venture interests. These positive factors were partially offset by increased interest expense related primarily to the $600 million Senior Notes offering in July 2011 and higher selling, general and administrative expenses attributable to increased employee costs, incentive compensation and contract services associated with growth in the business.

Analysis of Segment Operating Income

We manage our operations through four operating segments: Crude Oil Pipelines, Crude Oil Acquisition and Marketing, Terminal Facilities and Refined Products Pipelines.

Crude Oil Pipelines

Our Crude Oil Pipelines consists of crude oil trunk and gathering pipelines in the southwest and midwest United States. Revenues are generated from tariffs and the associated fees paid by shippers utilizing our transportation services to deliver crude oil and other feedstocks to refineries within those regions. Rates for shipments on these pipelines are regulated by the FERC, Oklahoma Corporation Commission (OCC) and the Railroad Commission of Texas (Texas R.R.C.).

The following table presents the operating results and key operating measures for our Crude Oil Pipelines for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions, except for barrel amounts)			
Sales and other operating revenue:				
Unaffiliated customers	$ 72	$ 52	$ 187	$ 141
Affiliates				6
Intersegment revenue	36	29	101	86
Total sales and other operating revenue	$ 108	$ 81	$ 288	$ 233
Depreciation and amortization expense	$ 6	$ 7	$ 19	$ 19
Operating Income	$ 67	$ 43	$ 183	$ 129
Pipeline throughput (thousands of barrels per day ("bpd"))	1,601	1,637	1,546	1,591
Pipeline revenue per barrel (cents)	73.6	54.0	68.0	53.7

Operating income for the Crude Oil Pipelines increased $24 million to $67 million for the three months ended September 30, 2012, as compared to $43 million for the three months ended September 30, 2011. The increase in operating income was driven primarily by higher pipeline fees which benefited from tariff increases relative to the prior year period, organic growth projects and an improved mix of pipeline movements which benefited from the demand for West Texas crude oil ($29 million). Partially offsetting these improvements were overall volume reductions ($2 million) and increased selling, general and administrative expenses ($2 million).

Operating income for the Crude Oil Pipelines increased $54 million to $183 million for the nine months ended September 30, 2012, as compared to $129 million for the nine months ended September 30, 2011. The increase in operating income was driven primarily by higher pipeline fees which benefited from tariff increases relative to the prior year period, organic growth projects and an improved mix of pipeline movements which benefited from the demand for West Texas crude oil ($61 million). Partially offsetting these improvements were increased selling, general and administrative expenses ($7 million) and overall volume reductions ($6 million).

Crude Oil Acquisition and Marketing

Our Crude Oil Acquisition and Marketing segment reflects the sale of gathered and bulk purchased crude oil. The crude oil acquisition and marketing operations generate substantial revenue and cost of products sold as a result of the significant volume of crude oil bought and sold. However, the absolute price levels of crude oil normally do not bear a relationship to gross margin, although the price levels significantly impact revenue and costs of products sold. As a result, period-to-period variations in revenue and cost of products sold are not generally meaningful in analyzing the variation in gross margin for the Crude Oil Acquisition and Marketing segment. The operating results of the Crude Oil Acquisition and Marketing segment are affected by overall levels of supply and demand for crude oil and relative fluctuations in market related indices. Generally, we expect a base level of earnings from our Crude Oil Acquisition and Marketing segment that may be optimized and enhanced when there is a high level of market volatility, favorable basis differentials and/or a steep contango or backwardated structure. Our management believes gross margin, which is equal to sales and other operating revenue less cost of products sold, operating expenses and depreciation and amortization, is a key measure of financial performance for the Crude Oil Acquisition and Marketing segment. Although we employ risk management activities, these margins are not fixed and will vary from period-to-period.

The following table presents the operating results and key operating measures for our Crude Oil Acquisition and Marketing for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions, except for barrel amounts)			
Sales and other operating revenue:				
Unaffiliated customers	$ 2,909	$ 2,671	$ 8,951	$ 6,780
Affiliates	101		307	247
Intersegment revenue				1
Total sales and other operating revenue	$ 3,010	$ 2,671	$ 9,258	$ 7,028
Depreciation and amortization expense	$ 6	$ 4	$ 16	$ 5
Impairment charge	$	$	$ 8	$
Operating Income(1)	$ 48	$ 41	$ 134	$ 75
Crude oil purchases (thousands of bpd)	692	723	674	654
Gross margin per barrel purchased (cents)(1)(2)	83.1	66.3	84.2	47.2
Average crude oil price (per barrel)	$ 92.19	$ 89.81	$ 96.20	$ 95.52

(1) In August 2011, the Partnership acquired a crude oil acquisition and marketing business from Texon L.P. Results from the acquisition are included from the acquisition date.

(2) Represents total segment sales and other operating revenue less cost of products sold and operating expenses and depreciation and amortization, divided by crude oil purchases.

Operating income for the Crude Oil Acquisition and Marketing segment increased $7 million to $48 million for the three months ended September 30, 2012, as compared to $41 million for the three months ended September 30, 2011. The increase in operating income was driven primarily by expanded crude oil margins which were the result of expansion in our crude oil trucking fleet and market related opportunities in West Texas. Operating results also benefited from improved margins from the crude oil acquisition and marketing assets acquired from Texon L.P. in the third quarter 2011.

Table of Contents

Operating income for the Crude Oil Acquisition and Marketing segment increased $59 million to $134 million for the nine months ended September 30, 2012, as compared to $75 million for the nine months ended September 30, 2011. The increase in operating income was driven primarily by expanded crude oil volumes and margins which were the result of expansion in our crude oil trucking fleet and market related opportunities in West Texas. Operating results were further improved by increased volumes and margins from the crude oil acquisition and marketing assets acquired from Texon L.P. in the third quarter 2011. Partially offsetting these improvements was an $8 million non-cash impairment charge related to a cancelled software project.

Terminal Facilities

Our Terminal Facilities segment consists primarily of crude oil and refined products terminals and a refined products acquisition and marketing business. The Terminal Facilities earn revenue by providing storage, terminalling, blending and other ancillary services to our customers, as well as through the sale of refined products.

The following table presents the operating results and key operating measures for our Terminal Facilities for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions, except for barrel amounts)			
Sales and other operating revenue:				
Unaffiliated customers	$ 65	$ 65	$ 264	$ 181
Affiliates	28	23	118	81
Intersegment revenue	8	6	24	17
Total sales and other operating revenue	$ 101	$ 94	$ 406	$ 279
Depreciation and amortization expense	$ 10	$ 8	$ 28	$ 24
Impairment charge and other matters	$	$	$ (10)	$
Operating Income(1)	$ 39	$ 33	$ 137	$ 96
Terminal throughput (thousands of bpd):				
Refined products terminals(1)	495	497	499	485
Nederland terminal	721	869	703	779
Refinery terminals(1)	381	483	369	422

(1) In July and August 2011, the Partnership acquired the Eagle Point tank farm and related assets and a refined products terminal located in East Boston, Massachusetts, respectively. Results from the acquisitions are included from their respective acquisition dates.

Operating income for the Terminal Facilities increased $6 million to $39 million for the three months ended September 30, 2012, as compared to $33 million for the three months ended September 30, 2011. The increase in operating income was due primarily to increased operating results from the Partnership s refined products acquisition and marketing activities ($6 million) and contributions from the 2011 acquisitions of the Eagle Point tank farm and a refined products terminal in East Boston, Massachusetts ($5 million). These positive factors were partially offset by reduced volumes from the idling of the Marcus Hook refinery in the fourth quarter 2011 ($2 million) and higher selling, general and administrative expenses ($2 million).

Operating income for the Terminal Facilities increased $41 million to $137 million for the nine months ended September 30, 2012, as compared to $96 million for the nine months ended September 30, 2011. Operating income for 2012 included non-recurring gains related to the reversal of certain regulatory obligations that were recorded in 2011 ($10 million) and a contract settlement associated with the Partnership s sale of the Big Sandy terminal and pipeline assets ($6 million). Excluding these items, operating income increased $25 million due to contributions from the 2011 acquisitions of the Eagle Point tank farm and a refined products terminal in East Boston, Massachusetts ($17 million), operating results from the Partnership s refined products acquisition and marketing activities ($12 million) and improved results from the Partnership s Nederland terminals ($5 million). Partially offsetting these increases were reduced volumes at the Partnership s refinery terminals related to the idling of Sunoco s Marcus Hook refinery in the fourth quarter 2011 ($4 million) and increased selling, general and administrative expenses ($5 million).

Table of Contents

Refined Products Pipelines

Our Refined Products Pipelines segment consists of refined products pipelines, including a two-thirds undivided interest in the Harbor pipeline and joint venture interests in four refined products pipelines in selected areas of the United States. The Refined Products Pipelines earn revenues by transporting refined products from refineries in the northeast, midwest and southwest United States to markets in 6 states and Canada. Rates for shipments on these pipelines are regulated by the Federal Energy Regulatory Commission (FERC) and the Pennsylvania Public Utility Commission (PA PUC).

The following table presents the operating results and key operating measures for our Refined Products Pipelines for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in millions, except for barrel amounts)			
Sales and other operating revenue:				
Unaffiliated customers	$ 20	$ 20	$ 58	$ 45
Affiliates	12	17	36	48
Intersegment revenue	1		2	
Total sales and other operating revenue	$ 33	$ 37	$ 96	$ 93
Depreciation and amortization expense	$ 4	$ 5	$ 13	$ 13
Impairment charge	$	$	$ 1	$
Operating Income(1)	$ 11	$ 11	$ 24	$ 24
Pipeline throughput (thousands of bpd)(1)(2)	576	605	565	496
Pipeline revenue per barrel (cents)(1)(2)	62.2	66.2	62.2	68.6

(1) In May 2011, the Partnership acquired a controlling financial interest in the Inland refined products pipeline. As a result of the acquisition, the Partnership accounted for the entity as a consolidated subsidiary. Results from the acquisition are included from the acquisition date.

(2) Excludes amounts attributable to equity interests which are not consolidated.

Operating income for the Refined Products Pipelines was consistent at $11 million for the three months ended September 30, 2012 and 2011, respectively. Increased equity income was related to the Partnership s joint venture interest in Explorer Pipeline Company which recognized a non-recurring gain on an asset sale ($4 million). This increase was offset by lower pipeline volumes and fees driven primarily by the idling of Sunoco s Marcus Hook refinery in the fourth quarter 2011 ($4 million).

Operating income for the Refined Products Pipelines was consistent at $24 million for the nine months ended September 30, 2012 and 2011, respectively. Operating income for 2012 includes non-recurring gains for a contract settlement associated with the Big Sandy refined products terminal and pipeline asset sale ($5 million) and the Explorer Pipeline Company asset sale discussed above ($4 million). Excluding these items, operating income for the Refined Products Pipelines decreased $9 million compared to the prior period. Increased contributions from the acquisition of the Inland refined products pipeline ($5 million) were offset by lower pipeline volumes and fees driven primarily by the idling of the Marcus Hook refinery ($9 million) and increased environmental remediation expenses associated with a pipeline release in the first quarter 2012 ($4 million).

Acquisition of Sunoco

On October 5, 2012, Sunoco was acquired by Energy Transfer Partners, L.P. (ETP). Prior to this transaction, Sunoco through its wholly-owned subsidiary Sunoco Partners LLC served as the Partnership s general partner and owned a two percent general partner interest, all of the incentive distribution rights and a 32.4 percent limited partner interest in the Partnership. In connection with the acquisition, Sunoco s interests in the general partner and limited partnership were contributed to ETP, resulting in a change of control of the Partnership s general partner. Sunoco continues to operate its retail marketing network and is expected to continue utilizing the Partnership s pipeline and tank assets.

The Partnership expects that the acquisition of Sunoco s interests by ETP will result in the termination of Sunoco Logistics Partners L.P. for federal income tax purposes. The Partnership will be considered to have terminated for federal income tax purposes if there is a sale or exchange of 50 percent or more of the total interests in our capital and profits within a twelve-month period. In order to determine whether a sale or exchange of 50 percent or more of capital and profits interests has occurred, we review information available to us regarding transactions involving transfers of our units, including units which are actively traded in the public market and transfers of units by our affiliates. Generally, the information that we obtain prior to year end is not sufficient to make a definitive determination, on a current basis, of whether there have been sales and exchanges of 50 percent or more of our capital and profits within the prior twelve-month period. However, given the level of Partnership interests acquired by ETP, it is likely that a termination of Sunoco Logistics Partners L.P. has occurred for federal income tax purposes.

The termination does not affect our classification as a partnership for federal income tax purposes, but instead, we would be treated as a new partnership for federal income tax purposes. This termination will require us to close our taxable year, make new elections as to various tax matters and reset the depreciation schedule for our depreciable assets for federal income tax purposes. The resetting of our depreciation schedule will result in a deferral of the depreciation deductions allowable in computing taxable income to our unitholders.

Liquidity and Capital Resources

Liquidity

Cash generated from operations and borrowings under the $585 million of credit facilities are our primary sources of liquidity. At September 30, 2012, we had net working capital of $157 million and available borrowing capacity under credit facilities of $406 million. Our working capital position reflects crude oil and refined products inventories based on historical costs under the last-in, first-out (LIFO) method of accounting. If the inventories had been valued at their current replacement cost, we would have had working capital of $305 million at September 30, 2012. We periodically supplement our cash flows from operations with proceeds from debt and equity financing activities.

Credit Facilities

The Partnership maintains two credit facilities to fund the Partnership s working capital requirements, finance acquisitions and capital projects and for general partnership purposes with total borrowing capacity of $550 million. The credit facilities consist of a $350 million unsecured credit facility which expires in August 2016 (the $350 million Credit Facility) and a $200 million unsecured credit facility which expires in August 2013 (the $200 million Credit Facility). Outstanding borrowings under these credit facilities were $170 million at September 30, 2012. There were no borrowings outstanding at December 31, 2011.

The Partnership s credit facilities contain various covenants limiting the Partnership s ability to incur indebtedness; grant certain liens; make certain loans, acquisitions and investments; make any material change to the nature of its business; or enter into a merger or sale of assets, including the sale or transfer of interests in the Operating Partnership s subsidiaries. The credit facilities also limit the Partnership, on a rolling four-quarter basis, to a maximum total consolidated debt to consolidated EBITDA ratio, as defined in the underlying credit agreement, of 5.0 to 1, which can generally be increased to 5.5 to 1 during an acquisition period. The Partnership s ratio of total debt to EBITDA was 2.3 to 1 at September 30, 2012, as calculated in accordance with the credit agreements.

In connection with the acquisition of Sunoco by ETP in October 2012, Sunoco s interests in the general partner and limited partnership were contributed to ETP, resulting in a change of control of the Partnership s general partner. This would have represented an event of default under the Partnership s credit facilities as the general partner interests would no longer be owned by Sunoco. During the third quarter 2012, the Partnership amended this provision of its credit facilities to avoid an event of default upon the transfer of the general partner interest to ETP.

In May 2012, West Texas Gulf Pipe Line Company, one of the Partnership s consolidated joint ventures, entered into a $35 million revolving credit facility (the $35 million Credit Facility) which expires in May 2015. The facility is available to fund West Texas Gulf s general corporate purposes including working capital and capital expenditures. The $35 million Credit Facility contains various covenants limiting West Texas Gulf s ability to grant certain liens; make certain loans, acquisitions and investments; make any material change to the nature of its business; or enter into a merger or sale of assets. The credit facility also limits West Texas Gulf, on a rolling four-quarter basis, to a minimum fixed charge coverage ratio, as defined in the underlying credit agreement. The ratio for the fiscal quarter ending September 30, 2012 shall not be less than 0.80 to 1. The minimum ratio fluctuates between 0.80 to 1 and 1.00 to 1 throughout the term of the revolver as specified in the credit agreement. In addition, the credit facility limits West Texas Gulf to a maximum leverage ratio of 2.00 to 1. West Texas Gulf s fixed charge coverage ratio and leverage ratio were 0.98 to 1 and 0.28 to 1, respectively, at September 30, 2012. Outstanding borrowings under this credit facility were $9 million at September 30, 2012.

Table of Contents

Cash Flows and Capital Expenditures

Net cash provided by operating activities for the nine months ended September 30, 2012 was $411 million compared with $215 million for the nine months ended September 30, 2011. Net cash provided by operating activities in 2012 related primarily to net income of $389 million and non-cash charges for depreciation and amortization of $76 million partially offset by $14 million in spending for environmental liabilities which are expected to be recovered under the Partnership s insurance programs and a $35 million increase in working capital. Net cash provided by operating activities in 2011 related primarily to net income of $243 million and non-cash charges for depreciation and amortization of $61 million. These sources were partially offset by an $89 million increase in working capital which was primarily the result of the Partnership s increased contango inventory positions.

Net cash used in investing activities for the nine months ended September 30, 2012 was $224 million compared with $518 million for the nine months ended September 30, 2011. Net cash used in investing activities in 2012 consisted primarily of expansion capital projects and maintenance capital on the Partnership s existing assets, partially offset by $11 million of proceeds received for the sale of the Big Sandy terminal and pipeline assets and the settlement of related throughput and deficiency contracts. Net cash used in investing activities in 2011 consisted primarily of the significant acquisitions ($396 million), as well as expansion capital projects and maintenance capital on the Partnership s existing assets.

Net cash used in financing activities for the nine months ended September 30, 2012 was $190 million compared with $309 million provided by financing activities for the nine months ended September 30, 2011. Net cash used in financing activities in 2012 resulted primarily from the $250 million repayment of 7.25% Senior Notes in February 2012 and $178 million in distributions paid to limited partners and the general partner. These uses of cash were partially offset by $179 million of net credit facility borrowings and a $69 million decrease in advances to affiliates. Net cash provided by financing activities for the nine months ended September 30, 2011 resulted from $595 million in net proceeds related to the August 2011 offering of the 2022 and 2042 Senior Notes. This source of cash was partially offset by $156 million in distributions paid to limited partners and the general partner, a $94 million increase in advances to affiliates and $32 million of net repayments under the Partnership s previous credit facilities.

Capital Requirements

Our operations are capital intensive, requiring significant investment to maintain, upgrade and enhance existing assets and to meet environmental and operational regulations. The capital requirements have consisted, and are expected to continue to consist, primarily of:

- Maintenance capital expenditures that extend the usefulness of existing assets, such as those required to maintain equipment reliability, tankage and pipeline integrity and safety, and to address environmental regulations,

- Expansion capital expenditures to acquire and integrate complementary assets to improve operational efficiencies or reduce costs and to expand existing and construct new facilities, such as projects that increase storage or throughput volume, and

- Major acquisitions to acquire and integrate complementary assets to grow the business, to improve operational efficiencies or reduce costs.

Table of Contents

The following table summarizes maintenance and expansion capital expenditures, including amounts paid for acquisitions, for the periods presented:

	Nine Months Ended September 30, 2012	2011
	(in millions)	
Maintenance	$ 29	$ 20
Expansion	206	102
Major Acquisitions [1]		494
Total	$ 235	$ 616

[1] Includes $98 million of Class A units issued in connection with the purchase of the Eagle Point tank farm. The Class A units converted to common units in July 2012.

Maintenance capital expenditures for both periods presented include recurring expenditures such as pipeline integrity costs, pipeline relocations, repair and upgrade of field instrumentation, including measurement devices, repair and replacement of tank floors and roofs, upgrades of cathodic protection systems, crude trucks and related equipment, and the upgrade of pump stations. The Partnership continues to estimate its maintenance capital spending to be approximately $50 million in 2012.

Expansion capital in 2012 included projects to expand upon the Partnership s refined products acquisition and marketing services, upgrade the service capabilities at the Eagle Point terminal, invest in the Partnership s crude oil infrastructure by increasing its pipeline capabilities through previously announced growth projects in West Texas and expanding the trucking fleet, increase service capabilities at the Partnership s Nederland terminal and convert certain refined products pipelines as part of the Mariner West Project. The Partnership expects total expansion capital of approximately $350 million for 2012, and $700 million in expansion capital during 2013, excluding major acquisitions. Expansion capital in 2011 included projects to expand upon the Partnership s existing butane blending business, increase the tankage at the Nederland facility and expand the Partnership s refined products platform in the southwest United States.

Major acquisitions during the nine months ended September 30, 2011 include the East Boston terminal for $73 million including inventory, the Texon crude oil purchasing and marketing business for $222 million including inventory, the Eagle Point tank farm for $100 million, and an 83.8 percent equity interest in Inland Corporation for $99 million, which owns a refined products pipeline system in Ohio.

We expect to fund capital expenditures, including any additional acquisitions, from cash provided by operations and, to the extent necessary, from the proceeds of borrowings under our credit facilities, other borrowings and the issuance of additional common units.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to various market risks, including changing interest rates and volatility in crude oil and refined products commodity prices. To manage such exposure, interest rates, inventory levels and expectations of future commodity prices are monitored when making decisions with respect to risk management.

Interest Rate Risk

We have interest-rate risk exposure for changes in interest rates relating to our outstanding borrowings. We manage our exposure to changing interest rates through the use of a combination of fixed-rate and variable-rate debt. At September 30, 2012, we had $179 million of variable-rate borrowings under the revolving credit facilities. Outstanding borrowings bear interest cost of LIBOR plus an applicable margin. Our weighted average interest rate on our variable-rate borrowings was approximately 1.5 percent at September 30, 2012. A one-percent change in the weighted average rate would have impacted annual interest expense by approximately $2 million.

At September 30, 2012, we had $1.45 billion of fixed-rate borrowings, which had an estimated fair value of $1.62 billion at September 30, 2012. A hypothetical one-percent decrease in interest rates would increase the fair value of our fixed-rate borrowings at September 30, 2012 by approximately $150 million.

Commodity Market Risk

We are exposed to volatility in crude oil and refined products commodity prices. To manage such exposures, inventory levels and expectations of future commodity prices are monitored when making decisions with respect to risk management and inventory carried. Our policy is to purchase only commodity products for which we have a market and to structure our sales contracts so that price fluctuations for those products do not materially affect the margin we receive. We also seek to maintain a position that is substantially balanced within our various commodity purchase and sale activities. We may experience net unbalanced positions for short periods of time as a result of production, transportation and delivery variances, as well as logistical issues associated with inclement weather conditions. When unscheduled physical inventory builds or draws do occur, they are monitored and managed to a balanced position over a reasonable period of time.

We do not use futures or other derivative instruments to speculate on crude oil or refined products prices, as these activities could expose us to significant losses. We do use derivative contracts as economic hedges against price changes related to our forecasted refined products purchase and sale activities. These derivatives are intended to have equal and opposite effects of the purchase and sale activities. At September 30, 2012, the fair market value of our open derivative positions was a net liability of $23 million on 3.9 million barrels of refined products. These derivative positions vary in length but do not extend beyond one year.

For additional information concerning our commodity market risk activities, see Note 13 to the Condensed Consolidated Financial Statements.

Forward-Looking Statements

Some of the information included in this quarterly report on Form 10-Q contains forward-looking statements and information relating to Sunoco Logistics Partners L.P. that is based on the current beliefs of our management as well as assumptions made by, and information currently available to, our management.

Forward-looking statements discuss expected future results based on current and pending business operations, and may be identified by words such as may, anticipates, believes, expects, estimates, planned, scheduled or similar phrases or expressions. Although we believe these forward-looking statements are reasonable, they are based upon a number of assumptions, any or all of which may ultimately prove to be inaccurate. These statements are subject to numerous assumptions, uncertainties and risks that may cause future results to be materially different from the results projected, forecasted, estimated or budgeted, including, but not limited to the following:

Our ability to successfully consummate announced acquisitions or expansions and integrate them into existing business operations;

Delays related to construction of, or work on, new or existing facilities and the issuance of applicable permits;

Changes in demand for, or supply of, crude oil and petroleum products that impact demand for our pipeline, terminalling and storage services;

Changes in the short-term and long-term demand for crude oil, refined petroleum products and natural gas liquids we buy and sell;

The loss of Sunoco as a customer or a significant reduction in its current level of throughput and storage with us;

Table of Contents

An increase in the competition encountered by our terminals, pipelines and crude oil and refined products acquisition and marketing operations;

Changes in the financial condition or operating results of joint ventures or other holdings in which we have an equity ownership interest;

Changes in the general economic conditions in the United States;

Changes in laws and regulations to which we are subject, including federal, state, and local tax, safety, environmental and employment laws;

Changes in regulations governing composition of the products that we transport, terminal and store;

Improvements in energy efficiency and technology resulting in reduced demand for petroleum products;

Our ability to manage growth and/or control costs;

The ability of ETP to successfully integrate our operations and employees, and realize anticipated synergies;

The effect of changes in accounting principles and tax laws and interpretations of both;

Global and domestic economic repercussions, including disruptions in the crude oil and petroleum products markets, from terrorist activities, international hostilities and other events, and the government s response thereto;

Changes in the level of operating expenses and hazards related to operating facilities (including equipment malfunction, explosions, fires, spills and the effects of severe weather conditions);

The occurrence of operational hazards or unforeseen interruptions for which we may not be adequately insured;

The age of, and changes in the reliability and efficiency of our operating facilities;

Changes in the expected level of capital, operating, or remediation spending related to environmental matters;

Changes in insurance markets resulting in increased costs and reductions in the level and types of coverage available;

Risks related to labor relations and workplace safety;

Non-performance by or disputes with major customers, suppliers or other business partners;

Changes in our tariff rates implemented by federal and/or state government regulators;

The amount of our debt, which could make us vulnerable to adverse general economic and industry conditions, limit our ability to borrow additional funds, place us at competitive disadvantages compared to competitors that have less debt, or have other adverse consequences;

Restrictive covenants in our credit agreements;

Changes in our or our general partner s credit ratings, as assigned by rating agencies;

The condition of the debt capital markets and equity capital markets in the United States, and our ability to raise capital in a cost-effective way;

Performance of financial institutions impacting our liquidity, including those supporting our credit facilities;

The effectiveness of our risk management activities, including the use of derivative financial instruments to hedge commodity risks;

Changes in interest rates on our outstanding debt, which could increase the costs of borrowing; and

The costs and effects of legal and administrative claims and proceedings against us or any entity in which we have an ownership interest, and changes in the status of, or the initiation of new litigation, claims or proceedings, to which we, or any entity in which we have an ownership interest, are a party.

These factors are not necessarily all of the important factors that could cause actual results to differ materially from those expressed in any of our forward-looking statements. Other unknown or unpredictable factors could also have material adverse effects on future results. We undertake no obligation to update publicly any forward-looking statement whether as a result of new information or future events.

Table of Contents

Item 4. Controls and Procedures

Disclosure controls and procedures are designed to ensure that information required to be disclosed in the Partnership s reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the Partnership s reports under the Exchange Act is accumulated and communicated to management, including the President and Chief Executive Officer and Chief Financial Officer of Sunoco Partners LLC (the Partnership s general partner), as appropriate, to allow timely decisions regarding required disclosure.

As of September 30, 2012, the Partnership carried out an evaluation, under the supervision and with the participation of the management of the general partner (including the President and Chief Executive Officer and the Chief Financial Officer), of the effectiveness of the design and operation of the Partnership s disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the general partner s President and Chief Executive Officer, and its Chief Financial Officer, concluded that the Partnership s disclosure controls and procedures are effective.

No change in the Partnership s internal control over financial reporting has occurred during the fiscal quarter ended September 30, 2012 that has materially affected, or that is reasonably likely to materially affect, the Partnership s internal control over financial reporting. The acquisition of Sunoco s interest in the general partner by ETP did not materially affect the Partnership s internal control over financial reporting.

Table of Contents

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

There are certain proceedings arising prior to the February 2002 initial public offering (IPO) pending against our Sunoco-affiliated predecessors and us (as successor to certain liabilities of those predecessors). Although the ultimate outcome of these proceedings cannot be ascertained at this time, it is reasonably possible that some of them may be resolved unfavorably. Sunoco has agreed to indemnify the Partnership for 100 percent of all losses from environmental liabilities related to the transferred assets arising prior to, and asserted within 21 years of February 8, 2002. There is no monetary cap on this indemnification from Sunoco. Sunoco s share of liability for claims asserted thereafter will decrease by 10 percent each year through the thirtieth year following the February 8, 2002 date. Any remediation liabilities not covered by this indemnity will be our responsibility. In addition, Sunoco is obligated to indemnify us under certain other agreements executed after the IPO.

The Partnership s Sunoco Pipeline L.P. subsidiary operates the West Texas Gulf Pipeline on behalf of West Texas Gulf Pipe Line Company and its shareholders pursuant to an Operating Agreement. Sunoco Pipeline L.P. also has a 60.3 percent ownership interest in the Company. In March 2010, Sunoco Pipeline L.P. received a Notice of Probable Violation, Proposed Civil Penalty and proposed Compliance Order from the Pipeline Hazardous Material Safety Administration (PHMSA) with proposed civil penalties in connection with a crude oil release that occurred at the Colorado City, Texas station on the West Texas Gulf Pipeline in June 2009. PHMSA issued a final order in August 2012 finding the Partnership in violation of all items identified in the original notice. The Partnership paid $0.4 million during the third quarter 2012 but has requested a petition for reconsideration on certain of the violations. The Partnership is awaiting a response from PHMSA.

There are certain other pending legal proceedings related to matters arising after the IPO that are not indemnified by Sunoco. Our management believes that any liabilities that may arise from these legal proceedings will not be material to our results of operations, cash flows or financial position at September 30, 2012.

Item 1A. Risk Factors

During 2011 and 2012, Sunoco, Inc. (Sunoco) executed a number of strategic transactions to facilitate its shift away from manufacturing. In addition to the sale of its Toledo, OH refinery in March 2011, Sunoco indefinitely idled the main processing units at the Marcus Hook, PA refinery in December 2011. Sunoco continues to pursue alternative strategic options for these assets. In September 2012, Sunoco completed the formation of Philadelphia Energy Solutions (PES), a joint venture with The Carlyle Group that will continue to operate the Philadelphia, PA refinery.

On October 5, 2012, Sunoco was acquired by Energy Transfer Partners, L.P. (ETP). Prior to this transaction, Sunoco, through its wholly owned subsidiary Sunoco Partners LLC, served as the Partnership s general partner and owned a two percent general partner interest, all of the incentive distribution rights and a 32.4 percent limited partner interest in the Partnership. In connection with the acquisition, Sunoco s interests in the general partner, including the incentive distribution rights, and limited partnership were contributed to ETP. This resulted in a change in control of the general partner, and as a result, the Partnership became a consolidated subsidiary of ETP subsequent to these transactions.

The Partnership has updated its risk factor information below to reflect the impacts of these transactions, including the change in the general partner ownership, and the ongoing business implications. If any of the following risks actually were to occur, our business, results of operations, financial condition and cash flows as well as any related benefits of owning our securities, could be materially and adversely affected.

RISKS RELATED TO OUR BUSINESS

If we are unable to generate sufficient cash flow, our ability to pay quarterly distributions to our common unitholders at current levels or to increase our quarterly distributions in the future, could be materially impaired.

Our ability to pay quarterly distributions depends primarily on cash flow, including cash flow from financial reserves and credit facilities, and not solely on profitability, which is affected by non-cash items. As a result, we may pay cash distributions during periods when we record net losses and may be unable to pay cash distributions during periods when we record net income. Our ability to generate sufficient cash from operations is largely dependent on our ability to successfully manage our business which may also be affected by economic, financial, competitive, and regulatory factors that are beyond our control. To the extent we do not have adequate cash reserves, our ability to pay quarterly distributions to our common unitholders at current levels could be materially impaired.

We depend upon Sunoco for a substantial portion of the volumes transported on our refined products pipelines and handled at our terminals. If Sunoco were to significantly reduce these volumes, it could materially and adversely affect our results of operations, financial condition or cash flows.

Our refined products pipeline and terminal assets provide a cost effective and efficient outlet to supply Sunoco s retail marketing network, and as such, we expect that Sunoco will continue to utilize our assets going forward. However, if Sunoco were to reduce its use of our facilities, it could adversely affect our results of operations, financial condition, or cash flows.

A sustained decrease in demand for refined products in the markets served by our pipelines and terminals could materially and adversely affect our results of operations, financial position, or cash flows.

The following are material factors that could lead to a sustained decrease in market demand for refined products:

- a sustained recession or other adverse economic condition that results in lower purchases of refined petroleum products;
- higher refined products prices due to an increase in the market price of crude oil, changes in economic conditions, or other factors;
- higher fuel taxes or other governmental or regulatory actions that increase, directly or indirectly, the cost of gasoline or other refined products;
- a shift by consumers to more fuel-efficient or alternative fuel vehicles or an increase in fuel economy, whether as a result of technological advances by manufacturers, pending legislation proposing to mandate higher fuel economy, or otherwise; and
- a temporary or permanent material increase in the price of refined products as compared to alternative sources of refined products available to our customers.

A material decrease in demand or distribution of crude oil available for transport through our pipelines or terminal facilities could materially and adversely affect our results of operations, financial position, or cash flows.

The volume of crude oil transported through our crude oil pipelines and terminal facilities depends on the availability of attractively priced crude oil produced or received in the areas serviced by our assets. A period of sustained crude oil price declines could lead to a decline in drilling activity, production and import levels in these areas. Similarly, a period of sustained increases in the price of crude oil supplied from any of these areas, as compared to alternative sources of crude oil available to our customers, could materially reduce demand for crude oil in these areas. In either case, the volumes of crude oil transported in our crude oil pipelines and terminal facilities could decline, and it could likely be difficult to secure alternative sources of attractively priced crude oil supply in a timely fashion or at all. If we are unable to replace any significant volume declines with additional volumes from other sources, our results of operations, financial position, or cash flows could be materially and adversely affected.

Any reduction in the capability of our shippers to utilize either our pipelines or interconnecting third-party pipelines could cause a reduction of volumes transported in our pipelines and through our terminals.

Users of our pipelines and terminals are dependent upon our pipelines, as well as connections to third-party pipelines, to receive and deliver crude oil and refined products. Any interruptions or reduction in the capabilities of our pipelines or these interconnecting pipelines due to testing, line repair, reduced operating pressures, or other causes would result in reduced volumes transported in our pipelines or through our terminals. Similarly, if additional shippers begin transporting volume over interconnecting pipelines, the allocations to our existing shippers on these interconnecting pipelines could be reduced, which also could reduce volumes transported in our pipelines or through our terminals. Allocation reductions of this nature are not infrequent and are beyond our control. Any such interruptions or allocation reductions that, individually or in the aggregate, are material or continue for a sustained period of time could have a material adverse effect on our results of operations, financial position, or cash flows.

If we are unable to complete capital projects at their expected costs and/or in a timely manner, or if the market conditions assumed in our project economics deteriorate, our results of operations, financial condition, or cash flows could be affected materially and adversely.

Delays or cost increases related to capital spending programs involving construction of new facilities (or improvements and repairs to our existing facilities) could adversely affect our ability to achieve forecasted operating results. Although we evaluate and monitor each capital spending project and try to anticipate difficulties that may arise, such delays or cost increases may arise as a result of factors that are beyond our control, including:

denial or delay in issuing requisite regulatory approvals and/or permits;

unplanned increases in the cost of construction materials or labor;

disruptions in transportation of modular components and/or construction materials;

severe adverse weather conditions, natural disasters, or other events (such as equipment malfunctions explosions, fires, spills) affecting our facilities, or those of vendors and suppliers;

shortages of sufficiently skilled labor, or labor disagreements resulting in unplanned work stoppages;

changes in market conditions impacting long lead-time projects;

market-related increases in a project s debt or equity financing costs; and

nonperformance by, or disputes with, vendors, suppliers, contractors, or sub-contractors involved with a project.

Our forecasted operating results also are based upon our projections of future market fundamentals that are not within our control, including changes in general economic conditions, availability to our customers of attractively priced alternative supplies of crude oil and refined products and overall customer demand.

Future acquisitions and expansions may increase substantially the level of our indebtedness and contingent liabilities, and we may be unable to integrate them effectively into our existing operations.

We evaluate and acquire assets and businesses that we believe complement or diversify our existing assets and businesses. Acquisitions may require substantial capital or the incurrence of substantial indebtedness. If we consummate any future material acquisitions, our capitalization and results of operations may change significantly.

Acquisitions and business expansions involve numerous risks, including difficulties in the assimilation of the assets and operations of the acquired businesses, inefficiencies and difficulties that arise because of unfamiliarity with new assets, new geographic areas and the businesses associated with them. Further, unexpected costs and challenges may arise whenever businesses with different operations or management are combined and we may experience unanticipated delays in realizing the benefits of an acquisition. In some cases, we have indemnified the previous owners and operators of acquired assets.

Following an acquisition, we may discover previously unknown liabilities associated with the acquired business for which we have no recourse under applicable indemnification provisions. In addition, the terms of an acquisition may require us to assume certain prior known or unknown liabilities for which we may not be indemnified or have adequate insurance.

Our operations are subject to operational hazards and unforeseen interruptions for which we may not be adequately insured.

Our operations and those of our customers and suppliers may be subject to operational hazards or unforeseen interruptions such as natural disasters, adverse weather, accidents, fires, explosions, hazardous materials releases, and other events beyond our control. If one or more of the facilities that we own or any third-party facilities that we receive from or deliver to, are damaged by any disaster, accident, catastrophe or other event, our operations could be significantly interrupted. These interruptions might involve a loss of equipment or life, injury, extensive property damage, or maintenance and repair outages. The duration of the interruption will depend on the seriousness of the damages or required repairs. We may not be able to maintain or obtain insurance to cover these types of interruptions, or in coverage amounts desired, at reasonable rates. In some instances, certain insurance could become unavailable or available only for reduced amounts of coverage. Any event that interrupts the revenues generated by our operations, or which causes us to make significant expenditures not covered by insurance, could materially and adversely affect our results of operations, financial position, or cash flows.

We are exposed to the credit and other counterparty risk of our customers in the ordinary course of our business.

We have various credit terms with virtually all of our customers, and our customers have varying degrees of creditworthiness. Although we evaluate the creditworthiness of each of our customers, we may not always be able to fully anticipate or detect deterioration in their creditworthiness and overall financial condition, which could expose us to an increased risk of nonpayment or other default under our contracts and other arrangements with them. In the event that a material customer or customers default on their payment obligations to us, this could materially adversely affect our results of operations, financial position, or cash flows.

Mergers among our customers and competitors could result in lower volumes being shipped on our pipelines or products stored in or distributed through our terminals, or reduced crude oil marketing margins or volumes.

Mergers between existing customers could provide strong economic incentives for the combined entities to utilize their existing systems instead of ours in those markets where the systems compete. As a result, we could lose some or all of the volumes and associated revenues from these customers and we could experience difficulty in replacing those lost volumes and revenues, which could materially and adversely affect our results of operations, financial position, or cash flows.

Rate regulation or market conditions may not allow us to recover the full amount of increases in our costs. Additionally, a successful challenge to our rates could materially and adversely affect our results of operations, financial position, or cash flows.

The primary rate-making methodology of the Federal Energy Regulatory Commission (FERC) is price indexing. We use this methodology in many of our interstate markets. In an order issued in December 2010, the FERC announced that, effective July 1, 2011, the index would equal the change in the producer price index for finished goods plus 2.65 percent (previously, the index was equal to the change in the producer price index for finished goods plus 1.3 percent). This index is to be in effect through July 2016. If the

Table of Contents

changes in the index are not large enough to fully reflect actual increases to our costs, our financial condition could be adversely affected. If the index results in a rate increase that is substantially in excess of the pipeline s actual cost increases, or it results in a rate decrease that is substantially less than the pipeline s actual cost decrease, the rates may be protested, and, if successful, result in the lowering of the pipeline s rates. The FERC s rate-making methodologies may limit our ability to set rates based on our true costs or may delay the use of rates that reflect increased costs.

Under the Energy Policy Act adopted in 1992, certain interstate pipeline rates were deemed just and reasonable or grandfathered. On our FERC-regulated pipelines, most of our revenues are derived from such grandfathered rates. A person challenging a grandfathered rate must, as a threshold matter, establish a substantial change since the date of enactment of the Act, in either the economic circumstances or the nature of the service that formed the basis for the rate. If the FERC were to find a substantial change in circumstances, then the existing rates could be subject to detailed review. There is a risk that some rates could be found to be in excess of levels justified by our cost of service. In such event, the FERC would order us to reduce rates prospectively and could order us to pay reparations to shippers. Reparations could be required for a period of up two years prior to the date of filing the complaint in the case of rates that are not grandfathered and for the period starting with the filing of the complaint in the case of grandfathered rates.

In addition, a state commission could also investigate our intrastate rates or terms and conditions of service on its own initiative or at the urging of a shipper or other interested party. If a state commission found that our rates exceeded levels justified by our cost of service, the state commission could order us to reduce our rates.

Potential changes to current rate-making methods and procedures may impact the federal and state regulations under which we will operate in the future. In addition, if the FERC s petroleum pipeline ratemaking methodology changes, the new methodology could materially and adversely affect our results of operations, financial position, or cash flows.

Our operations are subject to federal, state, and local laws and regulations relating to environmental protection and operational safety that could require substantial expenditures.

Our pipelines, gathering systems, and terminal operations are subject to increasingly strict environmental and safety laws and regulations. The transportation and storage of refined products and crude oil result in a risk that refined products, crude oil, and other hydrocarbons may be suddenly or gradually released into the environment, potentially causing substantial expenditures for a response action, significant government penalties, liability to government agencies for natural resources damages, personal injury, or property damage to private parties and significant business interruption. We own or lease a number of properties that have been used to store or distribute refined products and crude oil for many years. Many of these properties also have been previously owned or operated by third parties whose handling, disposal, or release of hydrocarbons and other wastes were not under our control, and for which, in some cases, we have indemnified the previous owners and operators.

Failure to comply with these laws and regulations may result in assessment of administrative, civil and criminal penalties, imposition of cleanup and site restoration costs and liens and, to a lesser extent, issuance of injunctions to limit or cease operations. We may be unable to recover these costs through increased revenues.

Our business is subject to federal, state and local laws and regulations that govern the product quality specifications of the petroleum products that we store and transport.

The petroleum products that we store and transport are sold by our customers for consumption into the public market. Various federal, state and local agencies have the authority to prescribe specific product quality specifications to commodities sold into the public market. Changes in product quality specifications could reduce our throughput volume, require us to incur additional handling costs or require the expenditure of significant capital. In addition, different product specifications for different markets impact the fungibility of products transported and stored in our pipeline systems and terminal facilities and could require the construction of additional storage to segregate products with different specifications. We may be unable to recover these costs through increased revenues.

In addition, the operations of our butane blending services are reliant upon gasoline vapor pressure specifications. Significant changes in such specifications could reduce butane blending opportunities, which would affect our ability to market our butane blending services licenses and which would ultimately affect our ability to recover the costs incurred to acquire and integrate the butane blending acquisition.

Climate change legislation or regulations restricting emissions of greenhouse gases could result in increased operating costs and reduced demand for our services.

The U.S. Senate has considered legislation to restrict U.S. emissions of carbon dioxide and other greenhouse gases (GHG) that may contribute to global warming and climate change. Many states, either individually or through multi-state regional initiatives, have begun implementing legal measures to reduce GHG emissions. The U.S. House of Representatives has previously approved legislation to establish a cap-and-trade program, whereby the U.S. Environmental Protection Agency (EPA) would issue a capped and steadily declining number of tradable emissions allowances to certain major GHG emission sources so they could continue to emit GHGs into the atmosphere. The cost of such allowances would be expected to escalate significantly over time, making the combustion of carbon-based fuels (*e.g.,* refined petroleum products, oil and natural gas) increasingly expensive. Beginning in 2011, EPA regulations required specified large domestic GHG sources to report emissions above a certain threshold occurring after January 1, 2010. Our facilities are not subject to this reporting requirement since our GHG emissions are below the applicable threshold. In addition, the EPA has proposed new regulations, under the federal Clean Air Act, that would require a reduction in GHG emissions from motor vehicles and could trigger permit review for GHG emissions from certain stationary sources. It is not possible at this time to predict how pending legislation or new regulations to address GHG emissions would impact our business. However, the adoption and implementation of federal, state, or local laws or regulations limiting GHG emissions in the U.S. could adversely affect the demand for our crude oil or refined products transportation and storage services, and result in increased compliance costs, reduced volumes or additional operating restrictions.

Terrorist attacks aimed at our facilities could adversely affect our business.

The U.S. government has issued warnings that energy assets, specifically the nation s pipeline and terminal infrastructure, may be the future targets of terrorist organizations. Any terrorist attack at our facilities, those of our customers and, in some cases, those of other pipelines, refineries, or terminals could materially and adversely affect our results of operations, financial position, or cash flows.

Our risk management policies cannot eliminate all commodity risk, and our use of hedging arrangements could result in financial losses or reduce our income. In addition, any non-compliance with our risk management policies could result in significant financial losses.

We follow risk management practices designed to minimize commodity risk, and engage in hedging arrangements to reduce our exposure to fluctuations in the prices of refined products. These hedging arrangements expose us to risk of financial loss in some circumstances, including when the counterparty to the hedging contract defaults on its contract obligations, or when there is a change in the expected differential between the underlying price in the hedging agreement and the actual prices received. In addition, these hedging arrangements may limit the benefit we would otherwise receive from increases in prices for such refined products.

The accounting standards regarding hedge accounting are very complex, and even when we engage in hedging transactions that are effective economically (whether to mitigate our exposure to fluctuations in commodity prices, or to balance our exposure to fixed and variable interest rates), these transactions may not be considered effective for accounting purposes. Accordingly, our condensed consolidated financial statements may reflect some volatility due to these hedges, even when there is no underlying economic impact at that point. In addition, it is not always possible for us to engage in a hedging transaction that completely mitigates our exposure to commodity prices. Our condensed consolidated financial statements may reflect a gain or loss arising from an exposure to commodity prices for which we are unable to enter into a completely effective hedge.

We have adopted risk management policies designed to manage risks associated with our businesses. However, these policies cannot eliminate all price-related risks, and there is also the risk of non-compliance with such policies. We cannot make any assurances that we will detect and prevent all violations of our risk management practices and policies, particularly if deception or other intentional misconduct is involved. Any violations of our risk management practices or policies by our employees or agents could result in significant financial losses.

We do not own all of the land on which our pipelines and facilities are located, and we lease certain facilities and equipment, and we are subject to the possibility of increased costs to retain necessary land use which could disrupt our operations.

We do not own all of the land on which certain of our pipelines and facilities are located, and we are, therefore, subject to the risk of increased costs to maintain necessary land use. We obtain the rights to construct and operate certain of our pipelines and related facilities on land owned by third parties and governmental agencies for a specific period of time. Our loss of these rights, through our inability to renew right-of-way contracts on acceptable terms or increased costs to renew such rights, could have a material adverse effect on our results of operations, financial condition and cash flows. In addition, we are subject to the possibility of increased costs under our rental agreements with landowners, primarily through rental increases and renewals of expired agreements.

Whether we have the power of eminent domain for our pipelines varies from state to state, depending upon the type of pipeline (*e.g*., crude oil, or refined products) and the laws of the particular state. In either case, we must compensate landowners for the use of their property and, in eminent domain actions, such compensation may be determined by a court. Our inability to exercise the power of eminent domain could negatively affect our business if we were to lose the right to use or occupy the property on which our pipelines are located.

Additionally, certain facilities and equipment (or parts thereof) used by us are leased from third parties for specific periods. Our inability to renew equipment leases or otherwise maintain the right to utilize such facilities and equipment on acceptable terms, or the increased costs to maintain such rights, could have a material adverse effect on our results of operations and cash flows.

A portion of our general and administrative services have been outsourced to third-party service providers. Fraudulent activity or misuse of proprietary data involving our outsourcing partners could expose us to additional liability.

We utilize both Sunoco and third parties in the processing of our information and data. Breaches of our security measures or the accidental loss, inadvertent disclosure or unapproved dissemination of proprietary information or sensitive or confidential data about us or our customers, including the potential loss or disclosure of such information or data as a result of fraud or other forms of deception, could expose us to a risk of loss or misuse of this information, result in litigation and potential liability for us, lead to reputational damage, increase our compliance costs, or otherwise harm our business. The Partnership continues to work with ETP in determining how the acquisition will impact these general and administrative functions going forward.

Security breaches and other disruptions could compromise our information and expose us to liability, which would cause our business and reputation to suffer.

In the ordinary course of our business, we collect and store sensitive data, including intellectual property, our proprietary business information and that of our customers, suppliers and business partners, and personally identifiable information of our employees, in our data centers and on our networks. The secure processing, maintenance and transmission of this information is critical to our operations and business strategy. Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. Any such breach could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such access, disclosure or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information, and regulatory penalties, disrupt our operations, and damage our reputation, and cause a loss of confidence in our products and services, which could adversely affect our business.

RISKS RELATED TO OUR PARTNERSHIP STRUCTURE

Our general partner s discretion in determining the level of cash reserves may adversely affect our ability to make cash distributions to our unitholders.

Our partnership agreement provides that our general partner may reduce operating surplus by establishing cash reserves to provide funds for our future operating expenditures. In addition, the partnership agreement provides that our general partner may reduce available cash by establishing cash reserves for the proper conduct of our business, to comply with applicable law or agreements to which we are a party or to provide funds for future distributions to our unitholders in any one or more of the next four quarters. These cash reserves will affect the amount of cash available for current distribution to our unitholders.

Even if unitholders are dissatisfied, they have limited rights under the Partnership agreement to remove our general partner without its consent, which could lower the trading price of the common units.

The partnership agreement also contains provisions limiting the ability of unitholders to call meetings or to acquire information about our operations, as well as other provisions limiting the unitholders ability to influence the manner or direction of management. Unlike the holders of common stock in a corporation, unitholders have only limited voting rights on matters affecting our business and, therefore, limited ability to influence management s decisions regarding our business. Unitholders did not elect our general partner or its board of directors and will have no right to elect our general partner or its board of directors on an annual or other continuing basis. The board of directors of our general partner is chosen by ETP, the sole member of our general partner. Furthermore, if the unitholders are dissatisfied with the performance of our general partner, they will have little ability to remove our general partner. As a result of these limitations, the price at which the common units trade could be diminished because of the absence or reduction of a control premium in the trading price.

The control of our general partner may be transferred to a third party without unitholder consent.

Our general partner has the right to transfer its general partner interest to a third party in a merger or in a sale of all or substantially all of its assets without the consent of the unitholders. Furthermore, there is no restriction in the partnership agreement on the ability of the owner of our general partner from transferring its ownership interest in the general partner to a third party. The new owner of our general partner would then be in a position to replace the board of directors and officers of the general partner with its own appointees.

Conflicts of interest may arise between us and ETP, as the owner of our general partner which, due to limited fiduciary responsibilities, may permit ETP and its affiliates to favor their own interests to the detriment of our unitholders.

ETP owns and controls our two percent general partner interest and owns 32.4 percent of our limited partnership interests. Conflicts of interest may arise, from time to time, between ETP and its affiliates (including our general partner), on the one hand, and us and our unitholders, on the other hand. As a result of these conflicts, our general partner may favor its own interests and the interests of its affiliates (including ETP) over the interests of our unitholders. These conflicts may include, among others, the following situations:

- ETP and its affiliates may engage in competition with us. Neither our partnership agreement nor any other agreement requires ETP to pursue a business strategy that favors us or utilizes our assets, and our general partner may consider the interests of parties other than us, such as ETP, in resolving conflicts of interest;

- under our partnership agreement, our general partner's fiduciary duties are restricted, and our unitholders have only limited remedies available in the event of conduct constituting a potential breach of fiduciary duty by our general partner;

- our general partner determines the amount and timing of asset purchases and sales, capital expenditures, borrowings, issuance of additional partnership securities, and reserves, each of which can affect the amount of cash available for distribution to our unitholders and the amount received by our general partner in respect of its incentive distribution rights (*IDRs*);

- our general partner determines which costs incurred by ETP and its affiliates are reimbursable by us; and

- our partnership agreement does not restrict our general partner from causing us to pay it or its affiliates for services rendered, or from entering into additional contractual arrangements with any of these entities on our behalf, so long as the terms of any additional contractual arrangements are fair and reasonable to us; and our general partner controls the enforcement of obligations owed to us by our general partner and its affiliates.

We are a holding company. We conduct our operations through our subsidiaries and depend on cash flow from our subsidiaries to pay distributions to our unitholders and service our debt obligations.

We are a holding company. We conduct our operations through our subsidiaries. As a result, our cash flow and ability to pay distributions to our unitholders and to service our debt is dependent upon the earnings of our subsidiaries. In addition, we are dependent on the distribution of earnings, loans or other payments from our subsidiaries to us. Any payment of dividends, distributions, loans or other payments from our subsidiaries to us could be subject to statutory or contractual restrictions. Payments to us by our subsidiaries also will be contingent upon the profitability of our subsidiaries. If we are unable to obtain funds from our subsidiaries we may not be able to pay distributions to our unitholders or pay interest or principal on our debt securities when due.

Our general partner may cause us to borrow funds in order to make cash distributions, even where the purpose or effect of the borrowing benefits the general partner or its affiliates.

Our general partner is a wholly owned subsidiary of ETP, and ETP also owns 32.4 percent of our limited partnership interests and all of our IDRs. Our general partner may cause us to borrow funds from affiliates of ETP or from third parties in order to pay cash distributions to our unitholders and to our general partner, including distributions with respect to our general partner s IDRs.

Our general partner has a limited call right that may require our unitholders to sell their common units at an undesirable time or price.

If at any time our general partner and its affiliates own more than 80 percent of the common units, our general partner will have the right, but not the obligation, which it may assign to any of its affiliates or to us, to acquire all, but not less than all, of the common units held by unaffiliated persons at a price not less than their then-current market price. As a result, unitholders may be required to sell their common units at an undesirable time or price, may not receive a return on the investment, and may incur a tax liability upon the sale.

We may issue additional common units without unitholder approval, which would dilute our unitholders ownership interests.

We may issue an unlimited number of common units or other limited partner interests, including limited partner interests that rank senior to our common units, without the approval of our unitholders. The issuance of additional common units, or other equity securities of equal or senior rank, will decrease the proportionate ownership interest of existing unitholders and reduce the amount of cash available for distribution to our common unitholders and may adversely affect the market price of our common units.

A unitholder may not have limited liability if a state or federal court finds that we are not in compliance with the applicable statutes or that unitholder action constitutes control of our business.

The limitations on the liability of holders of limited partner interests for the obligations of a limited partnership have not been clearly established in some states. A unitholder could be held liable in some circumstances for our obligations to the same extent as a general partner if a state or federal court determined that:

we had been conducting business in any state without complying with the applicable limited partnership statute; or

the right or the exercise of the right by the unitholders as a group to remove or replace our general partner, to approve some amendments to the partnership agreement, or to take other action under the partnership agreement constituted participation in the control of our business.

Under applicable state law, our general partner has unlimited liability for our obligations, including our debts and environmental liabilities, if any, except for our contractual obligations that are expressly made without recourse to our general partner.

In addition, Section 17-607 of the Delaware Revised Uniform Limited Partnership Act provides that under some circumstances a unitholder may be liable to us for the amount of a distribution for a period of three years from the date of the distribution.

RISKS RELATED TO OUR DEBT

References under this heading to we, us, and our mean Sunoco Logistics Partners Operations L.P. or Sunoco Partners Marketing & Terminals L.P.

We may not be able to obtain funding, or obtain funding on acceptable terms, to meet our future capital needs.

Global market and economic conditions have been, and continue to be volatile. The debt and equity capital markets have been impacted by, among other things, significant write-offs in the financial services sector and the re-pricing of credit risk in the broadly syndicated market.

As a result, the cost of raising money in the debt and equity capital markets could be higher and the availability of funds from those markets could be diminished if we seek access to those markets. Accordingly, we cannot be certain that additional funding will be available if needed and to the extent required, on acceptable terms. If additional funding is not available when needed, or is available only on unfavorable terms, we may be unable to implement our business plan, enhance our existing business, complete acquisitions or otherwise take advantage of business opportunities or respond to competitive pressures, any of which could have a material adverse effect on our revenues and results of operations.

Restrictions in our debt agreements may prevent us from engaging in some beneficial transactions or paying distributions to unitholders.

As of September 30, 2012, our total outstanding indebtedness was $1.63 billion. Our payment of principal and interest on the debt will reduce the cash available for distribution on our units, as will our obligation to repurchase the senior notes upon the occurrence of specified events involving a change in control of our general partner. In addition, we are prohibited by our credit facilities and the senior notes from making cash distributions during an event of default, or if the payment of a distribution would cause an event of default, under any of our debt agreements. Our leverage and various limitations in our credit facilities and our senior notes may reduce our ability to incur additional debt, engage in some transactions, and capitalize on acquisition or other business opportunities. Any subsequent refinancing of our current debt or any new debt could have similar or greater restrictions.

We could incur a substantial amount of debt in the future, which could prevent us from fulfilling our debt obligations.

We are permitted to incur additional debt, subject to certain limitations under our revolving credit facilities and, in the case of secured debt, under the indenture governing the notes. If we incur additional debt in the future, our increased leverage could, for example:

make it more difficult for us to satisfy our obligations under our debt securities or other indebtedness and, if we fail to comply with the requirements of the other indebtedness, could result in an event of default under our debt securities or such other indebtedness;

require us to dedicate a substantial portion of our cash flow from operations to required payments on indebtedness, thereby reducing the availability of cash flow from working capital, capital expenditures and other general corporate activities;

limit our ability to obtain additional financing in the future for working capital, capital expenditures and other general corporate activities;

limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;

detract from our ability to successfully withstand a downturn in our business or the economy generally; and

place us at a competitive disadvantage against less leveraged competitors.

Table of Contents

Rising short-term interest rates could increase our financing costs and reduce the amount of cash we generate.

As of September 30, 2012, we had $179 million of floating-rate debt outstanding. Rising short-term rates could materially and adversely affect our results of operations, financial condition or cash flows.

Any reduction in our credit ratings or in ETP s credit ratings could materially and adversely affect our business, results of operations, financial condition and liquidity.

We currently maintain an investment grade rating by Moody s, S&P and Fitch Ratings. However, our current ratings may not remain in effect for any given period of time and a rating may be lowered or withdrawn entirely by a rating agency if, in its judgment, circumstances in the future so warrant. If Moody s, S&P or Fitch Ratings were to downgrade our long-term rating, particularly below investment grade, our borrowing costs could significantly increase, which would adversely affect our financial results, and our potential pool of investors and funding sources could decrease. Further, due to our relationship with ETP, any down-grading in ETP s credit ratings could also result in a down-grading in our credit ratings. Ratings from credit agencies are not recommendations to buy, sell or hold our securities and each rating should be evaluated independently of any other rating.

TAX RISKS TO OUR COMMON UNITHOLDERS

Our tax treatment depends on our status as a partnership for federal income tax purposes, as well as our not being subject to a material amount of entity level taxation by individual states. If the Internal Revenue Service (IRS) treats us as a corporation or we become subject to a material amount of entity level taxation for state tax purposes, it would substantially reduce the amount of cash available for distribution to unitholders.

The anticipated after-tax economic benefit of an investment in the common units depends largely on our being treated as a partnership for federal income tax purposes. We have not requested, and do not plan to request, a ruling from the IRS on this matter. The IRS may adopt positions that differ from the ones we take. A successful IRS contest of the federal income tax positions we take may impact adversely the market for our common units, and the costs of any IRS contest will reduce our cash available for distribution to unitholders.

If we were treated as a corporation for federal income tax purposes, we would pay federal income tax at the corporate tax rate, and likely would pay state income tax at varying rates. Distributions to unitholders generally would be taxed again as corporate distributions. Treatment of us as a corporation would result in a material reduction in anticipated cash flow and after-tax return to unitholders. Current law may change so as to cause us to be treated as a corporation for federal income tax purposes or to otherwise subject us to a material level of entity-level taxation. States are evaluating ways to subject partnerships to entity level taxation through the imposition of state income, franchise and other forms of taxation. If any of these states were to impose a tax on us, the cash available for distribution to unitholders would be reduced. The partnership agreement provides that, if a law is enacted or existing law is modified or interpreted in a manner that subjects us to taxation as a corporation or otherwise subjects us to a material level of entity-level taxation for federal, state, or local income tax purposes, the minimum quarterly distribution amount and the target distribution amounts will be adjusted to reflect the impact of that law on us.

The sale or exchange of 50 percent or more of our capital and profit interests during any twelve-month period will result in our termination as a partnership for federal income tax purposes.

The Partnership expects that the acquisition of Sunoco s interests by ETP will result in the termination of Sunoco Logistics Partners L.P. for federal income tax purposes. Our Partnership will be considered to have terminated for federal tax purposes if there is a sale or exchange of 50 percent or more of the total interests in our capital and profits within a twelve-month period. In order to determine whether a sale or exchange of 50 percent or more of capital and profits interests has occurred, we review information available to us regarding transactions involving transfers of our units, including units which are actively traded in the public market and transfers of units by our affiliates. Generally, the information that we obtain prior to year end is not sufficient to make a definitive determination, on a current basis, of whether there have been sales and exchanges of 50 percent or more of our capital and profits within the prior twelve-month period. However, given the level of partnership interests acquired by ETP, it is likely that a termination of Sunoco Logistics Partners L.P. has occurred for federal income tax purposes.

The termination does not affect our classification as a partnership for federal income tax purposes, but instead, we would be treated as a new partnership for federal income tax purposes. This termination will require us to close our taxable year, make new elections as to various tax matters and reset the depreciation schedule for our depreciable assets for federal income tax purposes. The resetting of our depreciation schedule will result in a deferral of the depreciation deductions allowable in computing taxable income to our unitholders.

If treated as a new partnership, we must make new tax elections and could be subject to penalties if we are unable to determine that a termination occurred. The IRS has a relief procedure whereby if a publicly traded partnership that has technically terminated requests and the IRS grants special relief, among other things, the partnership may be permitted to provide only a single Schedule K-1 to unitholders for the tax years in which the termination occurs.

Our unitholders may be required to pay taxes on their share of our income even if they do not receive any cash distributions from us.

Because our unitholders will be treated as partners to whom we will allocate taxable income which will be different in amount than the cash we distribute, our unitholders will be required to pay any federal income taxes and, in some cases, state and local income taxes on their share of our taxable income even if they receive no cash distributions from us. Our unitholders may not receive cash distributions from us equal to their share of our taxable income or even equal to the actual tax liability that result from that income.

Tax gain or loss on disposition of our limited partner units could be more or less than expected.

If our unitholders sell their limited partner units, they will recognize a gain or loss equal to the difference between the amount realized and their tax basis in those limited partner units. Prior distributions to our unitholders in excess of the total net taxable income the unitholder was allocated for a unit, which decreased their tax basis in that unit, will, in effect, become taxable income to our unitholders if the limited partner unit is sold at a price greater than their tax basis in that limited partner unit, even if the price they receive is less than their original cost. A substantial portion of the amount realized, whether or not representing gain, may be ordinary income. In addition, if our unitholders sell their units, they may incur a tax liability in excess of the amount of cash received from the sale.

Tax-exempt entities and non-U.S. persons face unique tax issues from owning our common units that may result in adverse tax consequences to them.

Investment in common units by tax-exempt entities, such as individual retirement accounts (IRAs), and non-U.S. persons raises issues unique to them. For example, virtually all of our income allocated to organizations that are exempt from federal income tax, including individual retirement accounts and other retirement plans, will be unrelated business taxable income and will be taxable to them. Distributions to non-U.S. persons will be reduced by withholding taxes at the highest applicable effective tax rate, and non-U.S. persons will be required to file U.S. federal tax returns and pay tax on their share of our taxable income.

Our unitholders will likely be subject to state and local taxes and return filing requirements in states where they do not live as a result of investing in our limited partner units.

In addition to federal income taxes, our unitholders will likely be subject to other taxes, including state and local taxes, unincorporated business taxes and estate, inheritance or intangible taxes that are imposed by the various jurisdictions in which we do business or own property, even if they do not live in any of those jurisdictions. Our unitholders will likely be required to file state and local income tax returns and pay state and local income taxes in some or all of these various jurisdictions. Further, our unitholders may be subject to penalties for failure to comply with those requirements. We currently conduct our business and own assets in approximately 30 states, most of which impose a personal income tax. As we make acquisitions or expand our business, we may own assets or conduct business in additional states that impose a personal income tax. It is our unitholders responsibility to file all United States federal, state and local tax returns.

The tax treatment of publicly traded partnerships or an investment in our common units could be subject to potential legislative, judicial or administrative changes and differing interpretations, possibly on a retroactive basis.

The present federal income tax treatment of publicly traded partnerships, including us, or an investment in our common units, may be modified by administrative, legislative or judicial interpretation at any time. Any modification to the federal income tax laws and interpretations thereof may or may not be applied retroactively. Moreover, any such modification could make it more difficult or impossible for us to meet the exception which allows publicly traded partnerships that generate qualifying income to be treated as partnerships (rather than corporations) for U.S. federal income tax purposes, affect or cause us to change our business activities, or affect the tax consequences of an investment in our common units. For example, members of Congress have been considering substantive changes to the definition of qualifying income and the treatment of certain types of income earned from partnerships. While these specific proposals would not appear to affect our treatment as a partnership, we are unable to predict whether any of these changes, or other proposals, will ultimately be enacted. Any such changes could negatively impact the value of an investment in our common units.

Table of Contents

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

Table of Contents

Item 6. Exhibits

10.1:	$200,000,000 364-Day Revolving Credit Agreement dated as of August 14, 2012, among Sunoco Partners Marketing & Terminals L.P., as Borrower; Sunoco Logistics Partners Operations L.P. and Sunoco Logistics Partners L.P., as the Guarantors; Citibank, N.A., as Administrative Agent and as a Lender; Barclays Bank PLC, as a Lender; and the other Lenders Party Hereto
10.2:	First Amendment to the $350,000,000 Credit Agreement dated as of August 14, 2012, among Sunoco Logistics Partners Operations L.P., as the Borrower; Sunoco Logistics Partners L.P., as the Guarantor; the Undersigned Lenders and Citibank, N.A., as Administrative Agent, as a L/C Issuer and as Swing Line Lender
10.3:	Letter Agreement with Michael J. Hennigan, President and Chief Executive Officer, dated October 4, 2012
10.4:	Sunoco Partners LLC Long-Term Incentive Plan, as amended and restated effective October 24, 2012
12.1:	Statement of Computation of Ratio of Earnings to Fixed Charges
31.1:	Chief Executive Officer Certification of Periodic Report Pursuant to Exchange Act Rule 13a-14(a)
31.2:	Chief Financial Officer Certification of Periodic Report Pursuant to Exchange Act Rule 13a-14(a)
32.1:	Chief Executive Officer Certification of Periodic Report Pursuant to Exchange Act Rule 13a-14(b) and U.S.C. §1350
32.2:	Chief Financial Officer Certification of Periodic Report Pursuant to Exchange Act Rule 13a-14(b) and U.S.C. §1350
101.1:	The following financial statements from Sunoco Logistics Partners L.P. s Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2012 formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Statements of Comprehensive Income; (ii) the Condensed Consolidated Balance Sheets; (iii) the Condensed Consolidated Statements of Cash Flows; (iv) the Condensed Consolidated Statements of Equity; and (v) the Notes to Condensed Consolidated Financial Statements.

We are pleased to furnish this Form 10-Q to unitholders who request it by writing to:

Sunoco Logistics Partners L.P.

Investor Relations

1818 Market Street

Suite 1500

Philadelphia, PA 19103

or through our website at www.sunocologistics.com.

SIGNATURE

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.

Sunoco Logistics Partners L.P.

By: */S/ Martin Salinas, Jr.*
Martin Salinas, Jr.
Chief Financial Officer

Sunoco Partners LLC

Date: November 8, 2012

53