UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period September 30, 2006

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 1-9819

DYNEX CAPITAL, INC.
(Exact name of registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization)	**52-1549373** (I.R.S. Employer Identification No.)
4551 Cox Road, Suite 300, Glen Allen, Virginia (Address of principal executive offices)	**23060-6740** (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

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

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes o No þ

On September 30, 2006, the registrant had 12,131,262 shares outstanding of common stock, $.01 par value, which is the registrant's only class of common stock.

DYNEX CAPITAL, INC.
FORM 10-Q

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

DYNEX CAPITAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(amounts in thousands except share data)

	September 30, 2006	December 31, 2005
ASSETS		
Cash and cash equivalents	$ 52,285	$ 45,235
Securitized finance receivables, net	362,629	722,152
Securities	14,968	24,908
Other investments	3,069	4,067
Other mortgage loans	4,289	5,282
Investment in joint venture	36,618	-
Other assets	5,817	4,332
	$ 479,675	$ 805,976
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Securitization financing:		
Non-recourse securitization financing	$ 219,050	$ 516,578
Repurchase agreements secured by securitization financing	103,253	133,104
Repurchase agreements secured by securities	-	211
Obligation under payment agreement	16,369	-
Other liabilities	5,982	6,749
	344,654	656,642
Commitments and Contingencies (Note 12)		
SHAREHOLDERS' EQUITY		
Preferred stock, par value $0.01 per share, 50,000,000 shares authorized, 9.5% Cumulative Convertible Series D, 4,221,539 and 5,628,737 shares issued and outstanding, respectively, ($43,218 and $57,624 aggregate liquidation preference, respectively)	41,749	55,666
Common stock, par value $0.01 per share, 100,000,000 shares authorized, 12,131,262 and 12,163,391 shares issued and outstanding, respectively	121	122
Additional paid-in capital	366,637	366,903
Accumulated other comprehensive income	440	140
Accumulated deficit	(273,926)	(273,497)
	135,021	149,334
	$ 479,675	$ 805,976

See notes to unaudited condensed consolidated financial statements.

DYNEX CAPITAL, INC.
CONDENSED CONSOLIDATED STATEMENTS
OF OPERATIONS AND COMPREHENSIVE INCOME (UNAUDITED)
(amounts in thousands except share and per share data)

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Interest income:				
Securitized finance receivables	$ 11,863	$ 14,470	$ 38,888	$ 53,394
Securities	330	974	1,303	3,038
Other investments	613	124	1,303	1,255
Other loans	194	149	464	616
	13,000	15,717	41,958	58,303
Interest and related expenses:				
Non-recourse securitization financing	8,236	12,716	29,425	47,226
Repurchase agreements	1,533	365	4,567	1,256
Obligation under payment agreement	121	-	121	-
Other	(59)	22	(155)	18
	9,831	13,103	33,958	48,500
Net interest income	3,169	2,614	8,000	9,803
(Provision for) recapture of loan losses	(67)	(1,622)	52	(4,547)
Net interest income after provision for loan losses	3,102	992	8,052	5,256
Equity in loss of joint venture	(1,661)	-	(1,661)	-
Loss on capitalization of joint venture	(1,194)	-	(1,194)	-
Gain (loss) on sale of investments, net	85	(48)	226	9,802
Impairment charges	-	(207)	-	(2,259)
Other income (expense)	433	(1,026)	662	331
General and administrative expenses	(980)	(1,610)	(3,473)	(4,500)
Net (loss) income	(215)	(1,899)	2,612	8,630
Preferred stock charge	(1,003)	(1,336)	(3,041)	(4,010)
Net (loss) income to common shareholders	$ (1,218)	$ (3,235)	$ (429)	$ 4,620
Change in net unrealized gain/(loss) on:				
Investments classified as available-for-sale	(148)	(116)	300	(4,464)
Hedge instruments	-	21	-	605
Comprehensive (loss) income	$ (363)	$ (1,994)	$ 2,912	$ 4,771
Net (loss) income per common share:				
Basic and diluted	$ (0.10)	$ (0.27)	$ (0.04)	$ 0.38

See notes to unaudited condensed consolidated financial statements.

DYNEX CAPITAL, INC.
CONDENSED CONSOLIDATED STATEMENTS
OF CASH FLOWS (UNAUDITED)
(amounts in thousands)

	Nine Months Ended September 30,	
	2006	2005
Operating activities:		
Net income	$ 2,612	$ 8,630
Adjustments to reconcile net income to cash		
provided by operating activities:		
(Recapture of) provision for loan loss	(52)	4,547
Equity in loss of joint venture	1,661	
Impairment charges	-	2,259
Loss on capitalization of joint venture	1,194	-
Gain on sale of investments	(226)	(9,802)
Amortization and depreciation	246	1,425
Compensation expense for stock options	104	-
Net change in other assets and other liabilities	(576)	164
Net cash and cash equivalents provided by operating activities	4,963	7,223
Investing activities:		
Principal payments received on investments	77,776	106,593
Purchase of securities and other investments	(17,221)	(45,572)
Payments received on securities, other investments and loans	27,816	51,767
Proceeds from sales of securities and other investments	2,129	20,297
Other	886	171
Net cash and cash equivalents provided by investing activities	91,386	133,256
Financing activities:		
Principal payments on non-recourse securitization financing	(41,573)	(81,309)
Net (repayment of) borrowings under repurchase agreement	(30,062)	107,185
Redemption of securitization financing bonds	-	(195,653)
Retirement of common stock	(216)	-
Retirement of preferred stock	(14,072)	-
Dividends paid	(3,376)	(4,010)
Net cash and cash equivalents used for financing activities	(89,299)	(173,787)
Net increase (decrease) in cash and cash equivalents	7,050	(33,308)
Cash and cash equivalents at beginning of period	45,235	52,522
Cash and cash equivalents at end of period	$ 52,285	$ 19,214
Supplemental information:		
Interest paid during the period	35,383	48,189
Non-cash transactions:		
Acquisition of investment in joint venture	38,248	-

See notes to unaudited condensed consolidated financial statements.

NOTE 1 - BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and notes required by accounting principles generally accepted in the United States of America, hereinafter referred to as "generally accepted accounting principles," for complete financial statements. The condensed consolidated financial statements include the accounts of Dynex Capital, Inc. and its qualified real estate investment trust (REIT) subsidiaries and taxable REIT subsidiary (together, "Dynex" or the "Company"). All inter-company balances and transactions have been eliminated in consolidation.

The Company consolidates entities in which it owns more than 50% of the voting equity and control does not rest with others. The Company follows the equity method of accounting for investments with greater than 20% and less than a 50% interest in partnerships and corporate joint ventures or when it is able to influence the financial and operating policies of the investee but owns less than 50% of the voting equity. For all other investments, the cost method is applied.

The Company believes it has complied with the requirements for qualification as a REIT under the Internal Revenue Code (the "Code"). To the extent the Company qualifies as a REIT for federal income tax purposes, it generally will not be subject to federal income tax on the amount of its income or gain that is distributed as dividends to shareholders.

In the opinion of management, all significant adjustments, consisting of normal recurring accruals considered necessary for a fair presentation of the condensed consolidated financial statements have been included. The financial statements presented are unaudited. Operating results for the three and nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with generally accepted accounting principles have been omitted. The unaudited financial statements included herein should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed with the Securities and Exchange Commission.

The preparation of financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. The primary estimates inherent in the accompanying condensed consolidated financial statements are discussed below.

The Company uses estimates in establishing fair value for its financial instruments. Securities classified as available-for-sale are carried in the accompanying financial statements at estimated fair value. Estimates of fair value for securities are based on market prices provided by certain dealers, when available. When market prices are not available, fair value estimates are determined by calculating the present value of the projected cash flows of the instruments using market-based assumptions such as estimated future interest rates and estimated market spreads to applicable indices for comparable securities, and using collateral based assumptions such as prepayment rates and credit loss assumptions based on the most recent performance and anticipated performance of the underlying collateral.

The Company has credit risk on loans in its portfolio as discussed in Note 4. An allowance for loan losses has been estimated and established for currently existing losses in the loan portfolio, which are deemed probable as to their occurrence. The allowance for loan losses is evaluated and adjusted periodically by management based on the actual and estimated timing and amount of probable credit losses. Provisions made to increase or decrease the allowance for loan losses are presented as provision for losses in the accompanying condensed consolidated statements of operations. The Company's actual credit losses may differ from those estimates used to establish the allowance.

Certain amounts for 2005 have been reclassified to conform to the presentation adopted in 2006.

NOTE 2 - NET INCOME PER COMMON SHARE

Net income per common share is presented on both a basic and diluted per common share basis. Diluted net income per common share assumes the conversion of the convertible preferred stock into common stock, using the if-converted method, and stock appreciation rights and options to the extent that they are outstanding, using the treasury stock method, but only if these items are dilutive. The Series D preferred stock is convertible into one share of common stock for each share of preferred stock. The following table reconciles the numerator and denominator for both basic and diluted net income per common share for the three and nine months ended September 30, 2006 and 2005.

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2006		2005		2006		2005	
	Income	Weighted-Average Number Of Shares	Income	Weighted-Average Number Of Shares	Income	Weighted-Average Number Of Shares	Income	Weighted-Average Number Of Shares
Net (loss) income	$ (215)		$ (1,899)		$ 2,612		$ 8,630	
Preferred stock charge	(1,003)		(1,336)		(3,041)		(4,010)	
Net (loss) income to common shareholders	$ (1,218)	12,130,836	$ (3,235)	12,163,391	$ (429)	12,143,549	$ 4,620	12,162,951
Net (loss) income per share:								
Basic and diluted		$ (0.10)		$ (0.27)		$ (0.04)		$ 0.38
Reconciliation of shares not included in calculation of earnings per share due to anti-dilutive effect								
Series D preferred stock	$ 1,003	4,221,539	$ (1,336)	5,628,737	$ 3,041	4,267,930	$ (4,010)	5,628,737
Expense and incremental shares of stock appreciation rights	-	(63,902)	-	-	-	(70,615)	-	86
	$ 1,003	4,157,637	$ (1,336)	5,628,737	$ 3,041	4,197,315	$ (4,010)	5,628,823

NOTE 3 - SECURITIZED FINANCE RECEIVABLES

The following table summarizes the components of securitized finance receivables at September 30, 2006 and December 31, 2005:

	September 30, 2006	December 31, 2005
Collateral:		
Commercial mortgage loans	$ 232,118	$ 570,199
Single-family mortgage loans	125,621	161,058
	357,739	731,257
Funds held by trustees, including funds held for defeasance	7,404	6,648
Accrued interest receivable	2,430	5,114
Unamortized discounts and premiums, net	(455)	(1,832)
Loans, at amortized cost	367,118	741,187
Allowance for loan losses	(4,489)	(19,035)
	$ 362,629	$ 722,152

The finance receivables are encumbered by non-recourse securitized financing as discussed in Note 9.

During the third quarter of 2006, Dynex contributed its interests in approximately $279,003 of securitized finance receivables and the associated securitization trust and approximately $254,454 in related securitization financing debt in exchange for an interest in the newly formed joint venture (see Note 8) and recognized a loss on the capitalization of the joint venture of $1,194.

NOTE 4 - ALLOWANCE FOR LOAN LOSSES

The Company reserves for probable estimated credit losses on securitized finance receivables and other loans in its investment portfolio. The following table summarizes the aggregate activity for the allowance for loan losses for the three-month and nine-month periods ended September 30, 2006 and 2005, respectively:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Allowance at beginning of period	$ 14,869	$ 16,536	$ 19,035	$ 28,014
Provision for (recapture of) loan losses	67	1,622	(52)	4,547
Charge-offs, net of recoveries	(94)	(357)	(4,141)	(3,450)
Portfolio sold/transferred	(10,353)	-	(10,353)	(11,310)
Allowance at end of period	$ 4,489	$ 17,801	$ 4,489	$ 17,801

The Company identified $16,781 and $54,558 of impaired commercial mortgage loans at September 30, 2006 and December 31, 2005, respectively. The decline is primarily due to the contribution of one of the Company's three commercial loan securitizations to a joint venture during the three months ended September 30, 2006, which resulted in the reversal of $10,353 of allowance for loan losses. In addition, performance of the underlying real estate collateralizing the impaired loans improved and six non-performing loans with a total unpaid balance of $12,177 liquidated during the nine-month period ended September 30, 2006. At September 30, 2006 and December 31, 2005, the Company had approximately $3,195 and $39,758 of commercial mortgage loans that were sixty days or more delinquent.

NOTE 5 - OTHER INVESTMENTS

The following table summarizes the Company's other investments at September 30, 2006 and December 31, 2005:

	September 30, 2006	December 31, 2005
Delinquent property tax receivable securities	$ 2,528	$ 3,220
Real estate owned	541	847
	$ 3,069	$ 4,067

Delinquent property tax receivable securities include an unrealized gain of $213 and $55 at September 30, 2006 and December 31, 2005, respectively. Real estate owned is acquired from foreclosures on delinquent property tax receivables. During the nine months ended September 30, 2006 and 2005, the Company collected an aggregate of $1,482 and $2,279, respectively, on delinquent property tax receivables and securities, including net sales proceeds from the related real estate owned.

NOTE 6 - SECURITIES

The following table summarizes the fair value of the Company's securities classified as available-for-sale at September 30, 2006 and December 31, 2005:

	September 30, 2006		December 31, 2005	
	Fair Value	**Effective Interest Rate**	**Fair Value**	**Effective Interest Rate**
Securities, available-for-sale:				
Fixed-rate mortgage securities	$ 12,246	7.27%	$ 22,900	6.14%
Equity securities	2,512		1,602	
Other securities	-		320	
	14,758		24,822	
Gross unrealized gains	409		332	
Gross unrealized losses	(199)		(246)	
	$ 14,968		$ 24,908	

NOTE 7 - OTHER LOANS

The following table summarizes Dynex's carrying basis for other loans at September 30, 2006 and December 31, 2005, respectively.

	September 30, 2006	December 31, 2005
Single-family mortgage loans	$ 3,761	$ 4,825
Multifamily and commercial mortgage loan participations	971	995
	4,732	5,820
Unamortized discounts	(443)	(538)
	$ 4,289	$ 5,282

NOTE 8 - INVESTMENT IN JOINT VENTURE

On September 15, 2006, Issued Holdings Capital Corporation ("IHCC"), a wholly-owned subsidiary of the Company, DBAH Capital, LLC, a subsidiary of Deutsche Bank, A.G., and Dartmouth Investments, LLP formed a joint venture, Copperhead Ventures, LLC, in which the parties interest is 49.875%, 49.875% and 0.25%, respectively. In connection with the formation and initial capitalization of the joint venture, the Company contributed its interest in a commercial mortgage securitization trust issued by Commercial Capital Access One ("CCAO"), and additionally agreed under a payment agreement to make payments to the joint venture based on cash flows received by the Company from a second commercial mortgage securitization trust.

The Company's interests in the commercial mortgage securitization trust contributed to the joint venture included three subordinate commercial mortgage backed securities and the redemption rights for all of the outstanding non-recourse securitization financing bonds issued by that trust. The contribution of these interests resulted in the derecognition of the related collateral of $279,003 and securitization financing of $254,454, the capitalization of $1,354 of accrued interest to which the Company retained the right to receive and the recognition of a loss of $1,194 for the quarter ended September 30, 2006.

The Company also entered into a payment agreement, which requires it to remit all of the cash flows received on its interests in a second commercial securitization to the joint venture. The Company has the right to repurchase this agreement from the joint venture at any time at its then fair value, and the Company has the right of first refusal should the joint venture decide to sell the agreement in the future. The Company has recorded an investment in and a liability to the joint venture equal to the estimated fair value of the future estimated cash flows of the trust. The difference between the gross cash flows and the recorded liability is amortized into interest expense using the effective interest method.

The total fair value of the consideration contributed by the Company for its interest in the joint venture was $37,281, which exceeded its proportionate share of the net assets of the joint venture at formation by $967. This difference is recorded in investment in joint venture and will be amortized over the estimated life of the joint venture as a charge to the Company's equity in the earnings or loss of the joint venture.

The Company accounts for its investment in the joint venture using the equity method, under which it recognizes its proportionate share of the joint ventures earnings or loss and changes in accumulated other comprehensive income. The Company recorded $1,661 for its equity in the net loss of the joint venture and $18 for the increase in accumulated other comprehensive income of the joint venture for the quarter ended September 30, 2006. The joint venture's loss related to the impairment of one of the joint venture's commercial mortgage backed securities due to an increase in the estimate of the loss on the liquidation of a foreclosed loan collateralizing the security.

NOTE 9 - NON-RECOURSE SECURITIZATION FINANCING

Dynex, through limited-purpose finance subsidiaries, has issued bonds pursuant to indentures in the form of non-recourse securitization financing. Each series of securitization financing may consist of various classes of bonds, either at fixed or variable rates of interest. Payments received on securitized finance receivables and any reinvestment income thereon are used to make payments on the securitization financing (see Note 3). The obligations under the securitization financings are payable solely from the securitized finance receivables and are otherwise non-recourse to Dynex. The stated maturity date for each class of bonds is generally calculated based on the final scheduled payment date of the underlying collateral pledged. The actual maturity of each class will be directly affected by the rate of principal prepayments on the related collateral. Each series is also subject to redemption at Dynex's option according to specific terms of the respective indentures. As a result, the actual maturity of any class of a series of securitization financing is likely to occur earlier than its stated maturity. If Dynex does not exercise its option to redeem a class or classes of bonds when it first has the right to do so, the interest rates on the bonds not redeemed will automatically increase by 0.30% to 0.83%.

Dynex may retain certain bond classes of securitization financing issued, including investment grade classes, financing these retained bonds with equity. As these limited-purpose finance subsidiaries are included in the consolidated financial statements of Dynex, such retained bonds are eliminated in the consolidated financial statements, while the associated repurchase agreements outstanding, if any, are included as recourse debt.

The components of non-recourse securitization financing along with certain other information at September 30, 2006 and December 31, 2005 are summarized as follows:

	September 30, 2006		December 31, 2005	
	Bonds Outstanding	**Range of Interest Rates**	**Bonds Outstanding**	**Range of Interest Rates**
Fixed-rate classes	$ 213,188	6.6% - 8.8%	$ 509,923	6.6% - 8.8%
Accrued interest payable	1,480		3,438	
Deferred costs	(2,972)		(16,912)	
Unamortized net bond premium	7,354		20,129	
	$ 219,050		$ 516,578	
Range of stated maturities	2024-2027		2009-2028	
Number of series	2		3	

At September 30, 2006, the weighted-average coupon on the fixed rate classes was 6.9%. The average effective rate on non-recourse securitization financing, which includes the amortization of the related bond premium and deferred costs, was 7.6%, and 7.4%, for the nine months ended September 30, 2006 and the year ended December 31, 2005, respectively.

As discussed in Note 3 and Note 8, the Company contributed its interest in a securitization trust to a joint venture during the quarter resulting in the derecognition of approximately $254,454 of non-recourse securitization financing.

NOTE 10 - REPURCHASE AGREEMENTS

The Company uses repurchase agreements, which are recourse to the Company, to finance certain of its investments. The Company had repurchase agreements of $103,253 and $133,104, at September 30, 2006 and December 31, 2005, respectively, which are collateralized by certain of the Company's retained interests in a prior securitization. The repurchase agreements mature monthly and have a weighted average rate of 0.10% over one-month LIBOR (5.37% at September 30, 2006). The securitization financing bonds collateralizing these repurchase agreements have a fair value of $118,570 at September 30, 2006 and pay interest at a blended rate of one-month LIBOR plus 0.10%.

Dynex has also utilized other recourse repurchase agreements to finance certain of its securities. These were all repaid during the three-months ended September 2006. There were $211 outstanding at December 31, 2005 which were collateralized by securities with a market value of $20,133.

NOTE 11 - PREFERRED STOCK

In January 2006, Dynex redeemed 1,407,198 shares of the outstanding 9.5% Series D Preferred stock with cash of $14,105.

At September 30, 2006 and December 31, 2005, the liquidation preference on the Preferred Stock was $43,218 and $57,624, respectively, and includes accrued dividends payable of $0.2375 per share or $1,003 and $1,337 at September 30, 2006 and December 31, 2005, respectively.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

As discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, the Company and certain of its subsidiaries are defendants in litigation. The following discussion is the current status of the litigation.

GLS Capital, Inc. ("GLS"), a subsidiary of the Company, and the County of Allegheny, Pennsylvania ("Allegheny County"), are defendants in a lawsuit in the Court of Common Pleas of Allegheny County, Pennsylvania (the "Court"). Plaintiffs allege that GLS illegally charged the taxpayers of Allegheny County certain attorney fees, costs and expenses, and interest in the collection of delinquent property tax receivables owned by GLS. On October 27, 2006, the Court certified the class action status of the litigation, which was originally filed in 1998. In its Order, the Court left open the possible decertification of the class if the fees, costs and expenses charged by GLS are in accordance with public policy considerations as well as the statute and relevant ordinance. The Company may seek to stay this action pending the outcome of other litigation before the Pennsylvania Supreme Court in which GLS is not directly involved but has filed an Amicus brief in support of the defendants. Plaintiffs have not enumerated its damages in this matter, and the Company believes that the ultimate outcome of this litigation will not have a material impact on its financial condition, but may have a material impact on reported results for the particular period presented.

The Company and Dynex Commercial, Inc. ("DCI"), formerly an affiliate of the Company and now known as DCI Commercial, Inc., are appellees (or "respondents") in the Court of Appeals for the Fifth Judicial District of Texas at Dallas, related to the matter of Basic Capital Management et al (collectively, "BCM" or "the Plaintiffs") versus Dynex Commercial, Inc. et al. Plaintiff's appeal seeks to overturn a judgment in favor of the Company and DCI which denied recovery to Plaintiffs, and to have a judgment entered in favor of Plaintiffs based on a jury award for damages against the Company of $253, and against DCI for $2,200 or $25,600, all of which was set aside by the trial court. In the alternative, Plaintiffs are seeking a new trial. The Court of Appeals heard the oral argument on the matter on April 18, 2006 but have not yet issued a ruling on the appeal.

On February 11, 2005, a putative class action complaint alleging violations of the federal securities laws and various state common law claims was filed against Dynex Capital, Inc., our subsidiary MERIT Securities Corporation, Stephen J. Benedetti, the Company's Executive Vice President, and Thomas H. Potts, the Company's former President and a former Director, in United States District Court for the Southern District of New York ("District Court") by the Teamsters Local 445 Freight Division Pension Fund ("Teamsters"). The lawsuit purported to be a class action on behalf of purchasers of MERIT Series 13 securitization financing bonds, which are collateralized by manufactured housing loans. On May 31, 2005, the

Teamsters filed an amended class action complaint. The amended complaint dropped all state common law claims but added federal securities claims related to the MERIT Series 12 securitization financing bonds. On July 15, 2005, the defendants moved to dismiss the amended complaint. On February 10, 2006, the District Court dismissed the claims against Messrs. Benedetti and Potts, but did not dismiss the claims against Dynex and MERIT. On February 24, 2006, Dynex and MERIT moved for reconsideration and interlocutory appeal of the District Court's order denying the motion to dismiss Dynex and MERIT. The Company has evaluated the allegations and believes them to be without merit and intends to continue to vigorously defend itself against them.

Although no assurance can be given with respect to the ultimate outcome of the above litigation, the Company believes the resolution of these lawsuits will not have a material effect on our consolidated balance sheet but could materially affect our consolidated results of operations in a given year.

NOTE 13 - STOCK BASED COMPENSATION

Pursuant to Dynex's shareholder approved 2004 Stock Incentive Plan (the "Stock Incentive Plan"), Dynex may grant to eligible officers, directors and employees stock options, stock appreciation rights ("SARs") and restricted stock awards. An aggregate of 1,500,000 shares of common stock is available for distribution pursuant to the Employee Incentive Plan. Dynex may also grant dividend equivalent rights ("DERs") in connection with the grant of options or SARs.

Effective January 1, 2006, Dynex adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment, (SFAS 123(R)) using the modified-prospective-transition method. Under this transition method, compensation cost in 2006 includes cost for options granted prior to but not vested as of December 31, 2005, and options vested in 2006. Therefore results for prior periods have not been restated.

On January 2, 2005, Dynex granted 126,297 SARs to certain of its employees and officers under the Stock Incentive Plan. The SARs vest over the next four years in equal annual installments, expire on December 31, 2011 and have an exercise price of $7.81 per share, which was the market price of the stock on the grant date.

On June 17, 2005, Dynex granted options to acquire an aggregate of 40,000 shares of common stock to the members of its Board of Directors under the Stock Incentive Plan. The options have an exercise price of $8.46 per share, which represents 110% of the closing stock price on the grant date, expire on June 17, 2010 and were fully vested when granted.

On January 12, 2006, Dynex granted 77,000 SARs to certain of its employees and officers under the Stock Incentive Plan. The SARs vest over the next four years in equal annual installments, expire on December 31, 2012 and have an exercise price of $6.61 per share, which was the market price of the stock on the grant date.

On June 16, 2006, the Company granted options to acquire an aggregate of 35,000 shares of common stock to the members of its Board of Directors under the Stock Incentive Plan, which had a fair value of approximately $64 on the grant date. The options have an exercise price of $7.43 per share, which represents 110% of the closing stock price on the grant date, expire on June 16, 2011, and were fully vested when granted.

The following table presents the 2005 effect on net income and earnings per share if the Company had applied the fair value method to the SARs and options granted to employees and Directors using the Black-Scholes option pricing model.

	Three Months Ended September 30, 2005	Nine Months Ended September 30,2005
Net (loss) income to common shareholders	$ (3,235)	$ 4,620
Fair value method stock based compensation expense	2	(98)
Pro forma net (loss) income to common shareholders	$ (3,233)	$ 4,522
Net (loss) income per common share:		
Basic and diluted - as reported	$ (0.27)	$ 0.38
Basic and diluted - pro forma	$ (0.27)	$ 0.37

The following table presents a summary of the SAR activity for the Stock Incentive Plan:

	Three Months Ended September 30, 2006		Nine Months Ended September 30, 2006	
	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
SARs outstanding at beginning of period	203,297	$ 7.36	126,297	$ 7.81
SARs granted	-	-	77,000	6.61
SARs forfeited or redeemed	-	-	-	-
SARs exercised	-	-	-	-
SARs outstanding at end of period	203,297	$ 7.36	203,297	$ 7.36
SARs vested and exercisable	31,574	$ 7.81	31,574	$ 7.81

The following table presents a summary of the option activity for the Stock Incentive Plan:

	Three Months Ended September 30, 2006		Nine Months Ended September 30, 2006	
	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
Options outstanding at beginning of period	75,000	$ 7.98	40,000	$ 8.46
Options granted	-	-	35,000	7.43
Options forfeited or redeemed	-	-	-	-
Options exercised	-	-	-	-
Options outstanding at end of period	75,000	$ 7.98	75,000	$ 7.98
Options vested and exercisable	75,000	$ 7.98	75,000	$ 7.98

NOTE 14 - RECENT ACCOUNTING PRONOUNCEMENTS

In February 2006, the FASB issued SFAS 155, “Accounting for Certain Hybrid Financial Instruments”. Key provisions of SFAS 155 include: (1) a broad fair value measurement option for certain hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation; (2) clarification that only the simplest separations of interest payments and principal payments qualify for the exception afforded to interest-only strips and principal-only strips from derivative accounting under paragraph 14 of FAS 133 (thereby narrowing such exception); (3) a requirement that beneficial interests in securitized financial assets be analyzed to determine whether they are freestanding derivatives or whether they are hybrid instruments that contain embedded derivatives requiring bifurcation; (4) clarification that concentrations of credit risk in the form of subordination are not embedded derivatives; and (5) elimination of the prohibition on a Qualified Special Purpose Entity ("QSPE") holding passive derivative financial instruments that pertain to beneficial interests that are or contain a derivative financial instrument. In general, these changes will reduce the operational complexity associated with bifurcating embedded derivatives, and increase the number of beneficial interests in securitization transactions, including interest-only strips and principal-only strips, required to be accounted for in accordance with FAS 133. Management does not believe that SFAS 155 will have a material effect on the financial statements of the Company.

On September 25, 2006, the FASB met and determined to propose a scope exception under FAS 155 for securitized interests that only contain an embedded derivative that is tied to the prepayment risk of the underlying prepayable financial assets, and for which the investor does not control the right to accelerate the settlement. If a securitized interest contains any other embedded derivative (for example, an inverse floater), then it would be subject to the bifurcation tests in FAS 133, as would securities purchased at a significant premium. The FASB plans to expose the proposed guidance for a 30-day comment period in the form of a FAS 133 Derivatives Implementation Issue in early November; re-deliberate the issue in December 2006 following the completion of the 30-day comment period, and issue their final position in early 2007.

The Company does not expect that the January 1, 2007 anticipated adoption of FAS 155 will have a material impact. However, to the extent that certain of the Company's future investments in securitized financial assets do not meet the scope exception ultimately adopted by the FASB, the Company's future results of operations may exhibit volatility as certain of its future investments may be marked to market value in their entirety through the income statement. Under the current accounting rules, changes in the market value of the Company's investment securities are made through other comprehensive income, a component of stockholders' equity.

In March 2006 the FASB issued SFAS No.156, "Accounting for Servicing of Financial Assets--an amendment of FASB Statement No. 140" (SFAS 156). This Statement amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* with respect to the accounting for separately recognized servicing assets and servicing liabilities. This Statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations and to initially measure those servicing assets and servicing liabilities at fair value, if practicable. SFAS 156 permits an entity to measure each class of separately recognized servicing assets and servicing liabilities by either amortizing the servicing asset or liability and assessing the mortgage servicing asset or servicing liability for impairment at each reporting date. Alternatively, an entity may choose to measure the servicing asset or servicing liability at fair value at each reporting date and report changes in fair value in earnings in the period the changes occur. SFAS 156 permits, at its initial adoption, a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value. This statement is effective as of the beginning of its first fiscal year that begins after September 15, 2006. The Company is currently evaluating the potential impact this statement may have on its financial statements.

In April 2006, the FASB issued FSP FIN 46(R)-6, "Determining the Variability to be Considered When Applying FASB Interpretation No.46(R)" ("FIN 46(R)-6"). FIN 46(R)-6 addresses the approach to determine the variability to consider when applying FIN 46(R). The variability that is considered in applying Interpretation 46(R) may affect (i) the determination as to whether an entity is a variable interest entity ("VIE"), (ii) the determination of which interests are variable in the entity, (iii) if necessary, the calculation of expected losses and residual returns on the entity, and (iv) the determination of which party is the primary beneficiary of the VIE. Thus, determining the variability to be considered is necessary to apply the provisions of Interpretation 46(R). FIN 46(R)-6 is required to be prospectively applied to entities in which the Company first become involved after July 1, 2006 and would be applied to all existing entities with which the Company is involved if and when a "reconsideration event" (as described in FIN 46) occurs. The Company is currently evaluating the impact of adopting FIN 46(R)-6 on its consolidated financial statements.

In September 2006, the FASB issued SFAS 157, Fair Value Measures (SFAS 157). This statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measures. This statement is effective as of the beginning of its first fiscal year that begins after November 15, 2007. The Company is currently evaluating the potential impact this statement may have on its financial statements.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108 (SAB 108). Due to diversity in practice among registrants, SAB 108 expresses the SEC staff views regarding the process by which misstatements in financials statements are evaluated for purposes of determining whether financial statement restatement is necessary. SAB 108 is effective for fiscal years ending after November 15, 2006, and early application is encouraged. The Company does not believe SAB 108 will have a material impact on its consolidated financials statements.

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

The following discussion and analysis of the financial condition and results of operations of the Company as of and for the three-month and nine-month periods ended September 30, 2006 should be read in conjunction with the Company's Unaudited Condensed Consolidated Financial Statements and the accompanying Notes to Unaudited Condensed Consolidated Financial Statements included in this report.

The Company is a specialty finance company organized as a real estate investment trust (REIT) that invests in loans and securities consisting principally of single family residential and commercial mortgage loans. The Company finances these loans and securities through a combination of non-recourse securitization financing, repurchase agreements, and equity. Dynex employs financing in order to increase the overall yield on its invested capital.

The Company has an Investment Policy which is reviewed and approved annually by the Board of Directors. The Investment Policy provides the framework for the allocation of the Company's investment capital into various funds or strategies, each with its own specific investment objective. These strategies or funds include a liquidity fund, consisting primarily of cash and equivalents, a fixed income fund, consisting primarily of highly-quality mortgage securities, a residual investment fund, consisting of primarily credit-sensitive investments with structured leverage (securitization financing), and a strategic fund, consisting primarily of equity and equity-like investments. The Company currently manages the capital allocated to these strategies but is currently seeking joint venture or other arrangements with money managers, Wall Street firms, other mortgage REITs, hedge funds, and specialty finance companies for leveraging their expertise and resources. To date the Company has had numerous discussions with potential third parties.

During the three-months ended September 30, 2006, the Company entered into a joint venture with an affiliate of Deutsche Bank, A.G. The Company invested in the joint venture in order to leverage its internal investment capabilities and to gain access to additional investment opportunities primarily in mortgage-related investments and special situations. In connection with the initial formation of the joint venture, the Company contributed its interests in $279.0 million of securitized finance receivables (backed by commercial mortgage loans) which had been pledged to a trust and which secured $254.5 million in securitization financing. As a result of the contribution, the Company derecognized these amounts from its consolidated balance sheet, and recognized a loss of $1.2 million on the transfer to the joint venture. Also in connection with the formation of the joint venture, the Company agreed to remit cash flows that it receives on an additional $182.4 million in securitized finance receivables, which collateralizes $165.7 million in securitization financing, by recording an investment in the joint venture and a corresponding liability of $16.4 million to reflect this commitment. The $182.4 million in securitized finance receivables and the $165.7 million in securitization financing will continue to be carried in the Company's financial statements. In return for the contributions discussed above, the Company received a 49.875% investment in the joint venture, an amount equal to that received by the Deutsche Bank affiliate. The Company's aggregate initial investment in the joint venture was $38.3 million. The Company views this joint venture as a means of diversifying its risk in the investments contributed to the joint venture, and also as a means of partnering on equal terms with a much larger organization, which has greater resources and capital and access to more investment opportunities than the Company currently does.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of the Company's financial condition and results of operations are based in large part upon its consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates.

Critical accounting policies are defined as those accounting policies that are reflective of significant judgments or uncertainties, and which may result in materially different results under different assumptions and conditions, or whose application may have a material impact on the Company's financial statements. The following are the Company's critical accounting policies.

Consolidation of Subsidiaries. The consolidated financial statements represent the Company's accounts after the elimination of inter-company transactions. The Company consolidates entities in which it owns more than 50% of the voting equity and control of the entity does not rest with others. The Company follows the equity method of accounting for investments with greater than 20% and less than a 50% interest in partnerships and corporate joint ventures or when it is able to influence the financial and operating policies of the investee but owns less than 50% of the voting equity. For all other investments, the cost method is applied.

Impairments. The Company evaluates all securities in its investment portfolio for other-than-temporary impairments. A security is generally defined to be other-than-temporarily impaired if, for a maximum period of three consecutive quarters, the carrying value of such security exceeds its estimated fair value and we estimate, based on projected future cash flows or other fair value determinants, that the fair value will remain below the carrying value for the foreseeable future. If an other-than-temporary impairment is deemed to exist, the Company records an impairment charge to adjust the carrying value of the security down to its estimated fair value. In certain instances, as a result of the other-than-temporary impairment analysis, the recognition or accrual of interest will be discontinued and the security will be placed on non-accrual status.

Dynex considers an investment to be impaired if the fair value of the investment is less than its recorded cost basis. Impairments of other investments generally are considered to be other-than-temporary when the fair value remains below the carrying value for three consecutive quarters. If the impairment is determined to be other-than-temporary, an impairment charge is recorded in order to adjust the carrying value of the investment to its estimated value.

Allowance for Loan Losses. The Company has credit risk on loans pledged in securitization financing transactions and classified as securitized finance receivables in its investment portfolio. An allowance for loan losses has been estimated and established for currently existing probable losses. Factors considered in establishing an allowance include current loan delinquencies, historical cure rates of delinquent loans, and historical and anticipated loss severity of the loans as they are liquidated. The allowance for loan losses is evaluated and adjusted periodically by management based on the actual and estimated timing and amount of probable credit losses, using the above factors, as well as industry loss experience. Where loans are considered homogeneous, the allowance for loan losses is established and evaluated on a pool basis. Otherwise, the allowance for loan losses is established and evaluated on a loan-specific basis. Provisions made to increase the allowance are a current period expense to operations.

Generally, single-family loans are considered impaired when they are 60-days past due. Commercial mortgage loans are evaluated on an individual basis for impairment. Generally, given its collateral dependent nature, a commercial loan with a debt service coverage ratio of less than one is considered impaired. However, based on information specific to a commercial loan, commercial loans with a debt service coverage ratio less than one may not be considered impaired. Conversely, commercial loans with a debt service coverage ratio greater than one may be considered impaired. Certain of the commercial mortgage loans are covered by loan guarantees that limit the Company's exposure on these loans. The level of allowance for loan losses required for these loans is reduced by the amount of applicable loan guarantees. The Company's actual credit losses may differ from the estimates used to establish the allowance.

FINANCIAL CONDITION

Below is a discussion of the Company's financial condition.

(amounts in thousands except per share data)	September 30, 2006	December 31, 2005
Securitized finance receivables, net	$ 362,629	$ 722,152
Securities	14,968	24,908
Other mortgage loans	4,289	5,282
Other investments	3,069	4,067
Investment in joint venture	36,618	-
Non-recourse securitization financing	219,050	516,578
Repurchase agreements secured by securitization financing bonds	103,253	133,104
Obligation under payment agreement	16,369	-
Shareholders' equity	135,021	149,334
Common book value per share	7.65	7.65

Securitized finance receivables. Securitized finance receivables decreased to $362.6 million at September 30, 2006 compared to $722.2 million at December 31, 2005. This decrease of $359.5 million is primarily the result of the contribution of receivables backed by commercial mortgage loans with an amortized cost basis of $279.0 million in connection with the establishment of an investment in joint venture discussed further below. Also contributing to the decrease in securitized finance receivables was $62.3 million of unscheduled and $15.5 million of scheduled principal payments on the loan collateral and $2.7 million of other items principally related to the liquidation of certain foreclosed securitized commercial mortgage loans.

Securities. Securities decreased during the nine months ended September 30, 2006 by $9.9 million, to $15.0 million at September 30, 2006 from $24.9 million at December 31, 2005 due primarily to principal payments of $26.1 million received on securities during the period. This decrease was partially offset by $17.2 million of security purchases during the period. The Company sold $1.5 million of equity securities during the period for a gain of $0.1 million and had a net increase of $0.2 million in the net unrealized gain on securities.

Other investments. Other investments at September 30, 2006 consist of a security collateralized by delinquent property tax receivables. Other investments decreased from $4.1 million at December 31, 2005 to $3.1 million at September 30, 2006. This decrease is primarily the result of collections on the tax liens and proceeds from the sale of real estate owned properties which totaled of $1.7 million during the quarter. This decrease was partially offset by an increase in the unrealized gain of $0.2 million on the security and $0.5 million of capitalized costs.

Other motgage loans. Other mortgage loans decreased by $1.0 million from $5.3 million at December 31, 2005 to $4.3 million at September 30, 2006 due primarily to scheduled and unscheduled pay-downs during the period.

Investment in joint venture. The Company acquired a 49.875% interest in a joint venture during the quarter in exchange for certain its interests in one commercial mortgage securitization trust and the execution of an obligation under payment agreement discussed further below. The initial value ascribed to the investment in joint venture was $38.3 million. The investment in joint venture was reduced for the Company's proportionate share of the joint venture's losses for the quarter, which totaled $1.7 million and related to the impairment of one of the joint venture's commercial mortgage backed securities due to an increase in the estimate of the loss on the liquidation of a foreclosed loan collateralizing the security.

Non-recourse securitization financing. Non-recourse securitization financing decreased $297.5 million, from $516.6 million at December 31, 2005 to $219.1 million at September 30, 2006. This decrease was primarily a result of the derecognition of $253.1 million of securitization financing, which were collateralized by the commercial mortgage loans contributed to a joint venture. Also contributing to this decrease were principal payments of $41.6 million on the non-recourse securitization financing made from the collections on the related securitized finance receivables and premium amortization of approximately $3.1 million.

Repurchase Agreements. The balance of repurchase agreements declined to $103.3 million at September 30, 2006 from $133.3 million at December 31, 2005. The decrease was due to net repayments of $30.0 during the period as a result of principal received on the underlying investments being financed.

Obligation under payment agreement. The increase in the balance is due to the Company entering an agreement to remit to a joint venture all of the cash flows received on its interests in a commercial securitization, CCAO Series 2, as part of the intial capitalization of the joint venture.

Shareholders' equity. Shareholders' equity decreased to $135.0 million at September 30, 2006 from $149.3 million at December 31, 2005. This decrease was primarily the result of the redemption of 1,407,198 shares of Series D Preferred Stock and the repurchase of 32,560 shares of common stock during the nine months ended September 30, 2006, which contributed to a $14.3 million decrease in equity, and the preferred stock dividends of $3.0 million. These decreases were partially offset by net income of $2.6 million for the period, a $0.3 million increase in net unrealized gains on securities and a $0.1 increase in equity for the fair value of the stock options granted to the members of the Company's Board of Directors during the second quarter of 2006.

Supplemental Discussion of Investments

As further discussed below, the Company manages its investment portfolio on a net investment basis, consisting of the amortized cost basis or fair value of the investment less the associated external financing of the investment, if any. Below is the net basis of the Company's investments as of September 30, 2006. Excluded from this table are cash and cash equivalents, other assets, and other liabilities.

As the cash flows received on the Company's investments are generally subordinate to the obligations under the associated financing of the investment, the investment portfolio is evaluated and managed based on the net capital invested in that particular investment. Net capital invested is generally defined as the cost basis of the investment net of the associated financing for that investment. For securitized finance receivables, because the securitization financing is recourse only to the finance receivables pledged and is, therefore, not a general obligation of the Company, the risk on the investment in securitized finance receivables from an economic point of view is limited to the Company's net retained investment in the securitization trust.

Below is the net basis of Dynex's investments as of September 30, 2006. The fair value of the net investment in securitized finance receivables is based on the present value of the projected cash flow from the collateral, adjusted for the impact and assumed level of future prepayments and credit losses, less the projected principal and interest due on the securitization financing bonds owned by third parties. The fair value of securities is based on quotes obtained from third-party dealers, or from management estimates. The fair value of investment in joint venture is based on the fair value of the assets held by the joint venture. The fair value of other investments and loans is based on the projected cash flow from the collateral discounted at estimated market rates.

Estimated Fair Value of Net Investment

(amounts in thousands)	September 30, 2006			
	Amortized cost basis	Financing	Net investment basis	Fair value of net investment basis (1)
Securitized finance receivables:				
Single family mortgage loans	$ 127,951	$ 103,253	$ 24,698	$ 25,689
Commercial mortgage loans	239,167	235,419	3,748	3,610
Allowance for loan losses	(4,489)	-	(4,489)	-
	362,629	338,672	23,957	29,299
Securities:				
Investment grade single-family	11,624	-	11,624	11,819
Non-investment grade single-family	452	-	452	608
Equity and other	2,683	-	2,683	2,541
	14,759	-	14,759	14,968
Investment in joint venture	36,618	-	36,618	35,651
Other investments and loans	7,145	-	7,145	8,232
Net unrealized gain	422	-	422	-
Total portfolio assets	$ 421,573	$ 338,672	$ 82,901	$ 88,150

(1) *Fair values are based on dealer quotes or bids from independent third parties, and where dealer quotes are not available fair values are calculated as the net present value of expected future cash flows, discounted at 16%. Expected future cash flows were based on the forward LIBOR curve as of September 30, 2006, and incorporate the resetting of the interest rates on the adjustable rate assets to a level consistent with projected prevailing rates. Expected cash flows were also based on estimated prepayment speeds and credit losses on the underlying loans set forth in the table below. Increases or decreases in interest rates and index levels from those used would impact the calculation of fair value, as would differences in actual prepayment speeds and credit losses versus the assumptions set forth above. The fair value of the investment in joint venture represents the Company's proportionate share of the net assets of the joint venture, which are recorded at estimated fair value on the joint venture's books.*

The following table summarizes the assumptions used in estimating fair value for our net investment in securitized finance receivables and the cash flow related to those net investments at September 30, 2006.

(amounts in thousands)	Fair Value Assumptions				
Loan type	Weighted-average prepayment speeds	Annual Losses	Weighted-Average Discount Rate	Projected cash flow termination date	Cash flows received in 2006 (1)
Single-family mortgage loans	30% CPR	0.2%	16%	Anticipated final maturity 2024	$ 7,869
Commercial mortgage loans (2)	(3)	0.8% (5)	16%	(4)	$ 286

(1) *Represents the excess of the cash flows received on the collateral pledged over the cash flow requirements of the securitization financing bond security.*

(2) *Includes loans pledged to a securitization trust.*

(3) *Assumed constant prepayment rates (CPR) speeds generally are governed by underlying pool characteristics, prepayment lock-out provisions, and yield maintenance provisions. Loans currently delinquent in excess of 30 days are assumed liquidated in month six.*

(4) *Cash flow termination dates are modeled based on the repayment dates of the loans or optional redemption dates of the underlying securitization financing bonds.*

(5) *In addition to the constant default rate of 0.8%, loans which are currently greater than 30 days delinquent are assumed to take a 35% loss within six months.*

The following table presents the Net Basis of Investments of $82,901at September 30, 2006 included in the "Estimated Fair Value of Net Investment" table above by their rating classification. Investments in the unrated and non-investment grade classification primarily include other loans that have not been given a rating but that are substantially seasoned and performing loans. Securitization over-collateralization generally includes the excess of the securitized finance receivable collateral pledged over the bonds issued by the securitization trust.

(amounts in thousands)	September 30, 2006
Cash and cash equivalents	$ 52,285
Investments:	
AAA rated and agency MBS fixed income securities	21,611
AA and A rated fixed income securities	4,997
Unrated and non-investment grade	10,705
Securitization over-collateralization	8,970
Investment in joint venture	36,618
	$ 82,901

Supplemental Discussion of Common Equity Book Value

The Company believes that its shareholders, as well as shareholders of other companies in the mortgage REIT industry, consider book value per common share an important measure. The Company's reported book value per common share is based on the carrying value of the Company's assets and liabilities as recorded in the consolidated financial statements in accordance with generally accepted accounting principles. A substantial portion of the Company's assets are carried on a historical, or amortized, cost basis and not at estimated fair value. The table included in the "Supplemental Discussion of Investments"section above compares the amortized cost base of the Company's investments to their estimated fair value based on assumptions set forth in the table.

The Company believes that book value per common share, adjusted to reflect the carrying value of investments at their fair value (hereinafter referred to as 'Adjusted Common Equity Book Value), would also be a meaningful measure for its shareholders, representing effectively the estimated going-concern value for the Company. The following table calculates Adjusted Common Equity Book Value and Adjusted Common Equity Book Value per Share using the estimated fair value information contained in the "Estimated Fair Value of Net Investment" table above. The amounts set forth in the table in the Adjusted Common Equity Book Value column include all assets and liabilities of the Company at their estimated fair values, and exclude any value attributable to the Company's tax net operating loss carryforwards and other matters that might impact the value of the Company.

(amounts in thousands)	September 30, 2006 Book Value	September 30, 2006 Adjusted Book Value
Total portfolio assets (per table above)	$ 82,901	$ 88,150
Cash and cash equivalents	52,285	52,285
Other assets and liabilities, net	(165)	(165)
	135,021	140,270
Less: Preferred stock liquidation preference	(42,215)	(42,215)
Common equity book value and adjusted book value	$ 92,806	$ 98,015
Common equity book value per share and adjusted book value per share	$ 7.65	$ 8.08

RESULTS OF OPERATIONS

(amounts in thousands except per share information)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net interest income	$ 3,169	$ 2,614	$ 8,000	$ 9,803
(Provision for) recapture of loan losses	(67)	(1,622)	52	(4,547)
Net interest income after provision for losses	3,102	992	8,052	5,256
Equity in loss of joint venture	(1,661)	-	(1,661)	-
Loss on capitalization of joint venture	(1,194)	-	(1,194)	-
Gain (loss) on sale of investments, net	85	(48)	226	9,802
Impairment charges	-	(207)	-	(2,259)
Other income (expense)	433	(1,026)	662	331
General and administrative expenses	(980)	(1,610)	(3,473)	(4,500)
Net (loss) income	(215)	(1,899)	2,612	8,630
Preferred stock charge	(1,003)	(1,336)	(3,041)	(4,010)
Net (loss) income to common shareholders	(1,218)	(3,235)	(429)	4,620
Net (loss) income per common share:				
Basic and diluted	$ (0.10)	$ (0.27)	$ (0.04)	$ 0.38

Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005. The decrease in net loss and net loss per common share during the three months ended September 30, 2006 as compared to the same period in 2005 is primarily the result of a decrease of $1.6 million in provision for loan losses and an increase in other income (expense) of $1.5 million. These increases were partially offset by the recognition by Dynex of its proportionate share of the losses, $1.7 million, incurred during the three months ended September 30, 2006 incurred as a result of its participation in a joint venture with Deutsche Bank. Provisions for loan losses in the commercial loan portfolio decreased compared to the three months ended September 30, 2005 by $1.2 million due to the contribution of a securitization backed by commercial loans to the joint venture. The $0.4 million decrease in provisions for loan losses in the single family loan portfolio is the consequence of decreases in delinquencies of non-pool insured loans. The $1.5 million increase in other income (expense) reflects prepayment penalty income on prepaid commercial loans recorded in the current quarter, funds relating to a securitization issued by the Company that were released by the trustee during the current quarter, the recognition in 2005 of an escrow claim relating to potentially uncollectible property tax receivables sold to a third party in 2005 and the recognition in 2005 of a third party claim on prepayment penalties on voluntarily prepaid commercial loans.

Net interest income increased from $2.6 million to $3.1 million for the quarter ended September 30, 2006 from the same period in 2005 primarily as a result of the stabilization of one-month LIBOR during the 2006 period. Interest expense decreased more quickly than interest income as interest rates on securitized finance receivables continued to reset higher while interest rates on variable-rate securitization financing leveled off during the current period, which resulted in an increase in net interest income of $0.6 million. Net interest income after provision for loan losses for the three months ended September 30, 2006 increased to $3.1 million from $1.0 million for the same period for 2005. Provision for loan losses of $0.1 million were recognized during the three months ended September 30, 2006 compared to $1.6 million for the third quarter of 2005 as explained above.

The loss on capitalization of the joint venture was $1.2 million for the quarter ended September 30, 2006. The Company’s interests in one of the commercial mortgage securitization trusts were contributed to the joint venture resulting in the derecognition of the related collateral of $279.0 million and securitization financing of $254.5 million and the capitalization of $1.4 million of accrued interest which the Company retained the right to receive.

General and administrative expense decreased to $1.0 million for the three-months ended September 30, 2006 from $1.6 million for the same period in 2005. This decrease was primarily the result of the reductions in expenses associated with the Company's tax lien servicing operations and a decrease in accounting expenses.

Nine Months Ended September 30, 2006 Compared to Nine Months Ended September 30, 2005. The decrease in net (loss) income and net (loss) income per common share during the nine months ended September 30, 2006 as compared to the same period in 2005 is primarily the result of a gain of $8.2 million on the sale of securitized finance receivables and a gain of $1.4 million on the sale of four healthcare mezzanine loans that were realized during the nine months ended September 30, 2005, a decrease in net interest income of $1.8 million, and a $1.7 million equity in loss of joint venture. These decreases in net income were partially offset by a reduction in impairment charges to zero versus a $1.7 million impairment charge recognized in 2005 on the Company's investment in delinquent property tax receivables, a $4.6 million decrease in provision for loan losses and $1.0 million decrease in general and administrative expenses. The $4.6 million decrease in loan loss reserves resulted primarily from the transfer of commercial mortgage loans to a joint venture during the quarter ended September 30, 2006. General and administrative expense decreased due to the reductions in expenses associated with the Company's tax lien servicing operations and a decrease in accounting expenses.

Net interest income decreased from $9.8 million to $8.0 million for the nine months ended September 30, 2006 from the same period in 2005 essentially as a result of the sale in the second quarter of 2005 of two securitizations backed by manufactured housing loans. This sale resulted in the derecognition of $367.2 million in interest-earning assets and $363.9 million in interest-bearing liabilities. Net interest income after provision for loan losses for the nine months ended September 30, 2006 increased to $8.0 million from $5.3 million for the same period for 2005. Provision for loan losses decreased from an expense of $4.5 million for the nine months ended 2005 to a benefit of $0.1 million for the same period in 2006 due primarily to improvements in the performance of the commercial loan portfolio and decreased delinquencies in the Company's non-pool insured securitized single family loans.

General and administrative expense decreased to $3.5 million for the nine-months ended September 30, 2006 from $4.5 million for the same period in 2005. This decrease was primarily the result of the reductions in expenses associated with the Company's tax lien servicing operations and a decline in litigation related expenses. The following table summarizes the average balances of interest-earning assets and their average effective yields, along with the average interest-bearing liabilities and the related average effective interest rates, for each of the periods presented. Assets that are on non-accrual status are excluded from the table below for each period presented.

Average Balances and Effective Interest Rates

(amounts in thousands)	Three Months Ended September 30, 2006 Average Balance	2006 Effective Rate	2005 Average Balance	2005 Effective Rate	Nine Months Ended September 30, 2006 Average Balance	2006 Effective Rate	2005 Average Balance	2005 Effective Rate
Interest-earning assets[1]:								
Securitized finance receivables[2]	$ 563,518	8.41%	$ 788,361	7.34%	$ 654,585	7.92%	$ 986,768	7.21%
Cash	48,476	5.06%	16,543	2.99%	36,209	4.80%	35,173	2.47%
Securities	14,564	7.85%	81,894	4.66%	22,105	7.38%	75,707	5.09%
Other loans	4,596	16.90%	3,586	16.66%	4,894	12.65%	5,722	14.36%
Other investments	-	-%	-	-%	-	-%	4,050	19.83%
Total interest-earning assets	$ 631,154	8.21%	$ 890,384	7.05%	$ 717,793	7.77%	$ 1,107,420	7.00%
Interest-bearing liabilities:								
Non-recourse securitization financing[3]	$ 393,009	8.15%	$ 546,030	8.00%	$ 463,633	8.27%	$ 808,389	7.20%
Repurchase agreements secured by securitization financing	109,808	5.46%	160,100	3.60%	118,611	5.07%	94,560	3.45%
Repurchase agreements	25	5.58%	39,646	3.61%	113	4.98%	53,713	3.08%
Total interest-bearing liabilities	$ 502,842	7.56%	$ 745,776	6.82%	$ 582,357	7.62%	$ 956,662	6.60%
Net interest spread on all investments		0.65%		0.23%		0.15%		0.40%
Net yield on average interest-earning assets [4]		2.16%		1.31%		1.58%		1.29%

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

(2) Average balances exclude funds held by trustees of $7,419 and $2,479 for the three months ended September 30, 2006 and 2005, respectively, and $7,170 and $988 for the nine months ended September 30, 2006 and 2005, respectively.

(3) Effective rates are calculated excluding non-interest related securitization financing expenses. If included, the effective rate on interest-bearing liabilities would be 7.82% and 7.03% for the three months ended September 30, 2006 and 2005, respectively, and 7.77% and 6.76% for the nine months ended September 30, 2006 and 2005, respectively.

(4) Net yield on average interest-earning assets reflects net interest income excluding non-interest related securitization financing expenses divided by average interest earning assets for the period, annualized.

The net interest spread increased 41 basis points, to 0.64% for the three months ended September 30, 2006 from 0.23% for the same period in 2005. The net yield on average interest earning assets for the three months ended September 30, 2006 increased to 2.16% from 1.31% for the same period in 2005. The increase in the Company's net interest spread can be attributed primarily to an increase of 74 basis points in the effective rate on interest-bearing liabilities and an increase of 116 basis points in the effective rate on interest-earning assets, which are both principally a result of the sale of approximately $367.2 million of securitized finance receivables and the extinguishment of approximately $363.9 million of the related securitization financing bonds during the third quarter 2005 and the third quarter 2006 contribution of approximately $279.0 million of securitized finance receivables to a joint venture and the derecognition of approximately $254.5 million of the related securitization financing bonds. In addition, approximately $30 million of repurchase agreement financing outstanding at year-end 2005 was repaid in second and third quarters of 2006. These asset sales and repurchase agreement repayments resulted in the yields of remaining assets, which are unencumbered by financing expense, assuming a larger proportion of the net interest spread.

The net interest spread decreased 25 basis points, to 0.15% for the nine months ended September 30, 2006 from 0.40% for the same period in 2005. The net yield on average interest earning assets for the nine months ended September 30, 2006 increased relative to the same period in 2005, to 1.58% from 1.29%. The decline in the Company's net interest spread can be attributed primarily to an increase of 102 basis points in the effective rate on interest-bearing liabilities compared to an increase of 77 basis points in the effective rate on interest-earning assets. Amounts for 2005 in the above table include income recognized through May 2005 on the Company's delinquent property tax receivables portfolio, which were placed on non-accrual at the end of May 2005. There were also effective interest rate adjustments recorded in 2005 resulting in a decrease of $1.3 million from 2005. The sale of approximately $367.2 million of securitized finance receivables and the extinguishment of approximately $363.9 million of the related securitization financing bonds during the third quarter of 2005, the third quarter of 2006 transfer of approximately $279.0 million of securitized finance receivables and the extinguishment of approximately $254.5 million of the related securitization financing bonds and the repayment in the second and third quarters 2006 of approximately $30 million of repurchase agreement financing outstanding at year-end 2005 resulted in a lower overall net interest spread.

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

	Three Months Ended September 30, 2006 vs. 2005		
(amounts in thousands)	**Rate**	**Volume**	**Total**
Securitized finance receivables	$ 1,910	$ (4,526)	$ (2,616)
Cash and cash equivalents	128	361	489
Securities	445	(1,113)	(668)
Other loans	55	(10)	45
Total interest income	2,538	(5,288)	(2,750)
Securitization financing	797	(3,669)	(2,872)
Repurchase agreements	282	(647)	(365)
Total interest expense	1,079	(4,316)	(3,237)
Net interest income	$ 1,459	$ (972)	$ 487

(amounts in thousands)	Nine Months Ended September 30, 2006 vs. 2005 Rate	Volume	Total
Securitized finance receivables	$ 4,823	$ (19,358)	$ (14,535)
Cash and cash equivalents	631	20	651
Securities	1,050	(2,717)	(1,667)
Other loans	(29)	(122)	(151)
Other investments	(301)	(301)	(602)
Total interest income	6,174	(22,478)	(16,304)
Securitization financing	7,115	(19,946)	(12,831)
Repurchase agreements	426	(1,678)	(1,252)
Total interest expense	7,541	(21,624)	(14,083)
Net interest income	$ (1,367)	$ (854)	$ (2,221)

Note: The change in interest income and interest expense due to changes in both volume and rate, which cannot be segregated, has been allocated proportionately to the change due to volume and the change due to rate. This table excludes non-interest related dividends on equity securities, securitization financing expense, other interest expense and provision for credit losses.

For the nine months ended September 30, 2005 compared to the same period for 2006, average interest-earning assets declined $390 million, or approximately 35%. Approximately 44% of that decline resulted from the derecognition in 2005 of two securitization trusts collateralized by manufactured housing loans. Another large portion of such reduction relates to paydowns on the Company's adjustable-rate single-family mortgages.

Credit Exposures. The predominate securitization structure used by Dynex is non-recourse securitization financing, whereby loans and securities are pledged to a trust, and the trust issues bonds pursuant to an indenture. Generally these securitization structures use over-collateralization, subordination, third-party guarantees, reserve funds, bond insurance, mortgage pool insurance or any combination of the foregoing as a form of credit enhancement. From an economic point of view, the Company generally has retained a limited portion of the direct credit risk in these securities. In many instances, the Company retained the “first-loss” credit risk on pools of loans that it has securitized.

The following table summarizes the aggregate principal amount of certain or our investments; the direct credit exposure the Company has retained (represented by the amount of over-collateralization pledged and subordinated securities the Company owns), net of the credit reserves, premiums and discounts the Company maintains for such exposure; and the actual credit losses incurred for each quarter presented. Credit Exposure, Net of Credit Reserves is based on the credit risk retained by the Company for the loans and securities pledged to the securitization trust, from an economic point of view. The table includes any subordinated security retained by the Company if such subordinated security is rated below investment grade by one or more of the nationally recognized credit rating agencies. Credit Exposure, Net of Credit Reserves decreased from the third quarter 2005 by $7.8 million and from the fourth quarter of 2005 by $9.5 million as the result of the contribution of a securitization backed by commercial loans to a joint venture.

The table excludes other forms of credit enhancement from which the Company benefits, and based upon the performance of the underlying loans, may provide additional protection against losses. These additional protections include loss reimbursement guarantees with a remaining balance of $17.0 million and a remaining deductible aggregating $0.6 million on $16.3 million of securitized single-family mortgage loans which are subject to such reimbursement agreements; guarantees aggregating $6.9 million on $74.1 million of securitized commercial mortgage loans, whereby losses on such loans would need to exceed the respective guarantee amount before the Company would incur credit losses; and $36.5 million of securitized single-family mortgage loans which are subject to various mortgage pool insurance policies whereby all expected losses would be recoverable.

Credit Reserves and Actual Credit Losses

($ in millions)	Outstanding Loan Principal Balance	Credit Exposure, Net Of Credit Reserves	Actual Credit Losses	Credit Exposure, Net to Outstanding Loan Balance
2005, Quarter 3	$ 786.5	$ 29.3	$ 0.3	3.73%
2005, Quarter 4	753.2	31.0	0.0	4.12%
2006, Quarter 1	724.4	32.0	0.5	4.42%
2006, Quarter 2	693.8	33.1	6.6	4.77%
2006, Quarter 3	378.2	21.5	0.1	5.68%

The following tables summarize single-family mortgage loan and commercial mortgage loan delinquencies as a percentage of the outstanding securitized finance receivables balance for those securities in which we have retained a portion of the direct credit risk. We monitor and evaluate our exposure to credit losses and have established reserves based upon anticipated losses, general economic conditions and trends in the investment portfolio. At September 30, 2006, management believes the level of credit reserves is appropriate for currently existing losses within these loan pools.

Single family mortgage loan delinquencies as a percentage of the outstanding loan balance increased by approximately 1.67% to 8.67% at September 30, 2006 from 7.00% at September 30, 2005 and increased by 1.26% from 7.41% at December 31, 2005 due mostly to increased delinquencies in pool insured loans as the unpaid principal balance of the portfolio declines. The following table provides the percentage of delinquent single family loans.

Single-Family Loan Delinquency Statistics

	30 to 59 days delinquent	60 to 89 days delinquent	90 days and over delinquent (1)	Total
2005, Quarter 3	3.33%	1.43%	2.24%	7.00%
2005, Quarter 4	4.23%	0.61%	2.57%	7.41%
2006, Quarter 1	4.50%	0.85%	2.90%	8.25%
2006, Quarter 2	4.51%	1.09%	2.68%	8.28%
2006, Quarter 3	4.56%	1.28%	2.83%	8.67%

For commercial mortgage loans, the delinquencies as a percentage of the outstanding securitized finance receivables balance have decreased to 1.33% at September 30, 2006 from 6.90% at December 31, 2005, and from 8.04% at September 30, 2005, primarily due to the previously discussed contribution of a commercial mortgage loan securitization trust in connection with the capitalization of a joint venture. Also, a commercial loan with an unpaid principal balance of $7.8 million which was liquidated with a $6.8 million loss during the second quarter 2006.

Commercial Loan Delinquency Statistics

	30 to 59 days delinquent	60 to 89 days delinquent	90 days and over delinquent(1)	Total
2005, Quarter 3	-%	1.50%	6.54%	8.04%
2005, Quarter 4	-%	0.25%	6.65%	6.90%
2006, Quarter 1	1.25%	-%	6.38%	7.63%
2006, Quarter 2	1.09%	-%	5.15%	6.24%
2006, Quarter 3	-%	-%	1.33%	1.33%

(1) *Includes foreclosures, repossessions and real estate owned.*

RECENT ACCOUNTING PRONOUNCEMENTS

In February 2006, the FASB issued SFAS 155, "Accounting for Certain Hybrid Financial Instruments". Key provisions of SFAS 155 include: (1) a broad fair value measurement option for certain hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation; (2) clarification that only the simplest separations of interest payments and principal payments qualify for the exception afforded to interest-only strips and principal-only strips from derivative accounting under paragraph 14 of FAS 133 (thereby narrowing such exception); (3) a requirement that beneficial interests in securitized financial assets be analyzed to determine whether they are freestanding derivatives or whether they are hybrid instruments that contain embedded derivatives requiring bifurcation; (4) clarification that concentrations of credit risk in the form of subordination are not embedded derivatives; and (5) elimination of the prohibition on a QSPE holding passive derivative financial instruments that pertain to beneficial interests that are or contain a derivative financial instrument. In general, these changes will reduce the operational complexity associated with bifurcating embedded derivatives, and increase the number of beneficial interests in securitization transactions, including interest-only strips and principal-only strips, required to be accounted for in accordance with FAS 133. Management does not believe that SFAS 155 will have a material effect on the financial statements of the Company.

On September 25, 2006, the FASB met and determined to propose a scope exception under FAS 155 for securitized interests that only contain an embedded derivative that is tied to the prepayment risk of the underlying prepayable financial assets, and for which the investor does not control the right to accelerate the settlement. If a securitized interest contains any other embedded derivative (for example, an inverse floater), then it would be subject to the bifurcation tests in FAS 133, as would securities purchased at a significant premium. The FASB plans to expose the proposed guidance for a 30-day comment period in the form of a FAS 133 Derivatives Implementation Issue in early November; re-deliberate the issue in December 2006 following the completion of the 30-day comment period, and issue their final position in early 2007.

The Company does not expect that the January 1, 2007 anticipated adoption of FAS 155 will have a material impact. However, to the extent that certain of the Company's future investments in securitized financial assets do not meet the scope exception ultimately adopted by the FASB, the Company's future results of operations may exhibit volatility as certain of its future investments may be marked to market value in their entirety through the income statement. Under the current accounting rules, changes in the market value of the Company's investment securities are made through other comprehensive income, a component of stockholders' equity.

In March 2006 the FASB issued SFAS No.156, "Accounting for Servicing of Financial Assets--an amendment of FASB Statement No. 140" (SFAS 156). This Statement amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* with respect to the accounting for separately recognized servicing assets and servicing liabilities. This Statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations and to initially measure those servicing assets and servicing liabilities at fair value, if practicable. SFAS 156 permits an entity to measure each class of separately recognized servicing assets and servicing liabilities by either amortizing the servicing asset or liability and assessing the mortgage servicing asset or servicing liability for impairment at each reporting date. Alternatively, an entity may choose to measure the servicing asset or servicing liability at fair value at each reporting date and report changes in fair value in earnings in the period the changes occur. SFAS 156 permits, at its initial adoption, a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value. This statement is effective as of the beginning of its first fiscal year that begins after September 15, 2006. The Company is currently evaluating the potential impact this statement may have on its financial statements.

In April 2006, the FASB issued FSP FIN 46(R)-6, "Determining the Variability to be Considered When Applying FASB Interpretation No.46(R)" ("FIN 46(R)-6"). FIN 46(R)-6 addresses the approach to determine the variability to consider when applying FIN 46(R). The variability that is considered in applying Interpretation 46(R) may affect (i) the determination as to whether an entity is a variable interest entity ("VIE"), (ii) the determination of which interests are variable in the entity, (iii) if necessary, the calculation of expected losses and residual returns on the entity, and (iv) the determination of which party is the primary beneficiary of the VIE. Thus, determining the variability to be considered is necessary to apply the provisions of Interpretation 46(R). FIN 46(R)-6 is required to be prospectively applied to entities in which the Company first become involved after July 1, 2006 and would be applied to all existing entities with which the Company is involved if and when a "reconsideration event" (as described in FIN 46) occurs. The Company is currently evaluating the impact of adopting FIN 46(R)-6 on its consolidated financial statements.

In September 2006, the FASB issued SFAS 157, Fair Value Measures (SFAS 157). This statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measures. This statement is effective as of the beginning of its first fiscal year that begins after November 15, 2007. The Company is currently evaluating the potential impact this statement may have on its financial statements.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108 (SAB 108). Due to diversity in practice among registrants, SAB 108 expresses the SEC staff views regarding the process by which misstatements in financials statements are evaluated for purposes of determining whether financial statement restatement is necessary. SAB 108 is effective for fiscal years ending after November 15, 2006, and early application is encouraged. The Company does not believe SAB 108 will have a material impact on its consolidated financials statements.

LIQUIDITY AND CAPITAL RESOURCES

The Company has historically financed its operations from a variety of sources. The Company's primary source of funding its operations today is the cash flow generated from the investment portfolio, which includes net interest income and principal payments and prepayments on these investments. From the cash flow on its investment portfolio, the Company funds its operating overhead costs, including the servicing of its delinquent property tax receivables, pays the dividend on the Series D Preferred Stock and services any remaining recourse debt. The Company's investment portfolio continues to provide positive cash flow, which can be utilized for reinvestment purposes.

Cash flow from the investment portfolio for the three and nine months ended September 30, 2006 was approximately $5.6 million and $28.2 million, respectively, which includes approximately $2.1 million and $16.7 million, respectively, in principal payments on securities, including $400 thousand and $1.5 million, respectively, on the property tax receivable security. Such cash flow is after payment of principal and interest on the associated non-recourse securitization financing outstanding.

Excluding any cash flow derived from the sale or re-securitization of assets, and assuming that short-term interest rates remain stable, the Company anticipates that the cash flow from its investment portfolio will sequentially decline in 2006 as the investment portfolio continues to pay down, absent meaningful reinvestment of capital. The Company anticipates, however, that it will have sufficient cash flow from the investment portfolio to meet all of its current obligations on both a short-term and long-term basis.

During the second quarter 2006, the Company utilized available capital to purchase $0.6 million in equity securities of other publicly-traded mortgage REITs, and additional short-term investments. At September 30, 2006, the Company had unused capacity on uncommitted repurchase agreement lines of approximately $12.3 million and cash and equivalents of $52.3 million, and other short-term instruments of $46.9 million. Cash flow from the investment portfolio is subject to fluctuation due to changes in interest rates, repayment rates and default rates and related losses.

The Company intends to maintain high levels of liquidity for the foreseeable future given the lack of compelling reinvestment opportunities as a result of the low level of interest rates, the flat yield curve, and the historically tight spreads on fixed income instruments. The Board of Directors of Dynex also approved the redemption of up to one million shares of common stock of Dynex, and through September 30, 2006, the Company had purchased 32,560 such shares at an average effective price of $6.75. The repurchase of shares of common stock is likely to continue if alternative uses of the capital are not available and if such repurchases are accretive to book value per common share.

The Company currently utilizes a combination of equity, securitization financing and repurchase agreement financing to finance its investment portfolio. Securitization financing is recourse only to the assets pledged as collateral to support the financing and is not otherwise recourse to the Company. The maturity of each class of securitization financing is directly affected by the rate of principal prepayments on the related collateral and is not subject to margin call risk. Each series is also subject to redemption according to specific terms of the respective indentures, generally on the earlier of a specified date or when the remaining balance of the bonds equals 35% or less of the original principal balance of the bonds. At September 30, 2006, the Company had $219.1 million of non-recourse securitization financing outstanding, all of which carries a fixed rate of interest.

Repurchase agreement financing is recourse to the assets pledged, and to the Company. Repurchase agreement financing is not committed financing to the Company, and it generally renews or rolls every 30-days. The amounts advanced to the Company by the repurchase agreement counterparty are determined largely based on the fair value of the asset pledged to the counterparty.

FORWARD-LOOKING STATEMENTS

Certain written statements in this Form 10-Q made by the Company that are not historical fact constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements contained in this Item as well as those discussed elsewhere in this Report addressing the results of operations, our operating performance, events, or developments that we expect or anticipate will occur in the future, including statements relating to investment strategies, net interest income growth, earnings or earnings per share growth, and market share, as well as statements expressing optimism or pessimism about future operating results, are forward-looking statements. The forward-looking statements are based upon management’s views and assumptions as of the date of this report, regarding future events and operating performance and are applicable only as of the dates of such statements. Such forward-looking statements may involve factors that could cause the actual results of the Company to differ materially from historical results or from any results expressed or implied by such forward-looking statements. The Company cautions the public not to place undue reliance on forward-looking statements, which may be based on assumptions and anticipated events that do not materialize.

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

Reinvestment. Asset yields today are generally lower than those assets sold or repaid, due to lower overall interest rates and more competition for these assets. The Company has generally been unable to find investments which have acceptable risk adjusted yields. As a result, the Company’s net interest income has generally been declining, and may continue to decline in the future, resulting in lower earnings per share over time. In order to maintain our investment portfolio size and our earnings, the Company needs to reinvest a portion of the cash flows it receives into new interest earning assets. If the Company is unable to find suitable reinvestment opportunities, the net interest income on our investment portfolio and investment cash flows could be negatively impacted.

Economic Conditions. The Company is affected by general economic conditions. An increase in the risk of defaults and credit risk resulting from an economic slowdown or recession or other factors could result in a decrease in the value of our investments and the over-collateralization associated with our securitization transactions. As a result of our being heavily invested in short-term high quality investments, however, a worsening economy may potentially benefit the Company by creating opportunities for it to invest in assets that become distressed as a result of these worsening conditions. These changes could have an effect on our financial performance and the performance on our securitized loan pools.

Investment Portfolio Cash Flow. Cash flows from the investment portfolio fund our operations, the preferred stock dividend, and repayments of outstanding debt, and are subject to fluctuation due to changes in interest rates, repayment rates and default rates and related losses, particularly given the high degree of internal structural leverage inherent in our securitized investments. Cash flows from the investment portfolio are likely to sequentially decline until the Company meaningfully begins to reinvest its capital. There can be no assurances that the Company will be able to find suitable investment alternatives for its capital, nor can there be assurances that the Company will meet its reinvestment and return hurdles.

Defaults. Defaults by borrowers on loans it securitized may have an adverse impact on our financial performance, if actual credit losses differ materially from our estimates or exceed reserves for losses recorded in the financial statements. The allowance for loan losses is calculated on the basis of historical experience and management's best estimates. Actual default rates or loss severity may differ from our estimate as a result of economic conditions. Actual defaults on adjustable-rate mortgage loans may increase during a rising interest rate environment. In addition, commercial mortgage loans are generally large dollar balance loans, and a significant loan default may have an adverse impact on the Company's financial results. Such impact may include higher provisions for loan losses and reduced interest income if the loan is placed on non-accrual.

Investment in Joint Venture. The Company has an investment in a joint venture with an affiliate of Deutsche Bank, which currently owns subordinate commercial mortgage-backed securities ("CMBS") and cash. Defaults by borrowers on loans included in the CMBS in excess of those estimated may cause write-downs in the Company's recorded investment in the joint venture. In addition, there can be no assurances that the joint venture will be able to find suitable investment alternatives for its capital, nor can there be assurances that the Company will meet its reinvestment and return hurdles.

Interest Rate Fluctuations. Our income and cash flow depends on our ability to earn greater interest on our investments than the interest cost to finance these investments. Interest rates in the markets served by the Company generally rise or fall with interest rates as a whole. Approximately $239 million of our investments, including loans and securities currently pledged as securitized finance receivables and securities, are fixed-rate and approximately $110 million of our investments are variable rate. The Company currently finances these fixed-rate assets through $219 million of fixed rate securitization financing and $103 million of variable rate repurchase agreements. The net interest spread for these investments could decrease during a period of rapidly rising short-term interest rates, since the investments generally have interest rates which reset on a delayed basis and have periodic interest rate caps; the related borrowing has no delayed resets or such interest rate caps.

Third-party Servicers. Our loans and loans underlying securities are serviced by third-party service providers. As with any external service provider, the Company is subject to the risks associated with inadequate or untimely services. Many borrowers require notices and reminders to keep their loans current and to prevent delinquencies and foreclosures. A substantial increase in our delinquency rate that results from improper servicing or loan performance in general could harm our ability to securitize our real estate loans in the future and may have an adverse effect on our earnings.

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

Competition. The financial services industry is a highly competitive market in which the Company competes with a number of institutions with greater financial resources. In purchasing portfolio investments and in issuing securities, the Company competes with other mortgage REITs, investment banking firms, savings and loan associations, commercial banks, mortgage bankers, insurance companies, federal agencies and other entities, many of which have greater financial resources and a lower cost of capital than we do. Increased competition in the market and our competitors greater financial resources have adversely affected the Company, and may continue to do so. Competition may also continue to keep pressure on spreads resulting in the Company being unable to reinvest its capital at a satisfactory risk-adjusted basis.

Regulatory Changes. Our businesses as of and for the nine months ended September 30, 2006 were not subject to any material federal or state regulation or licensing requirements. However, changes in existing laws and regulations or in the interpretation thereof, or the introduction of new laws and regulations, could adversely affect us and the performance of our securitized loan pools or its ability to collect on its delinquent property tax receivables. The Company is a REIT and is required to meet certain tests in order to maintain its REIT status as described in the discussion of "Federal Income Tax Considerations" in its Annual Report on Form 10-K for the year ended December 31, 2005. If the Company should fail to maintain its REIT status, it would not be able to hold certain investments and would be subject to income taxes.

Other: The following risks, which are discussed in more detail in the Company's Annual Report on Form 10-K for the period ended December 31, 2005, could also affect the Company's results of operations, financial condition and cash flows:

- The Company may be unable to invest in new assets with attractive yields, and yields on new assets in which the Company does invest may not generate attractive yields, resulting in a decline in its earnings per share over time.

- The Company's ownership of certain subordinate interests in securitization trusts subjects it to credit risk on the underlying loans, and the Company provides for loss reserves on these loans as required under GAAP.

- Certain investments employ internal structural leverage as a result of the securitization process, and are in the most subordinate position in the capital structure, which magnifies the potential impact of adverse events on the Company's cash flows and reported results.

- The Company's efforts to manage credit risk may not be successful in limiting delinquencies and defaults in underlying loans or losses on its investments.

- Prepayments of principal on its investments, and the timing of prepayments, may impact the Company's reported earnings and our cash flows.

- The Company finances a portion of its investment portfolio with short-term recourse repurchase agreements which subjects it to margin calls if the assets pledged subsequently decline in value.

- The Company may be subject to the risks associated with inadequate or untimely services from third-party service providers, which may harm its results of operations.

- Interest rate fluctuations can have various negative effects on the Company, and could lead to reduced earnings and/or increased earnings volatility.

- The Company's reported income depends on accounting conventions and assumptions about the future that may change.

- Failure to qualify as a REIT would adversely affect the Company's dividend distributions and could adversely affect the value of its securities.

- Maintaining REIT status may reduce our flexibility to manage our operations.

- The Company may fail to properly conduct its operations so as to avoid falling under the definition of an investment company pursuant to the Investment Company Act of 1940.

- The Company is dependent on certain key personnel.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk generally represents the risk of loss that may result from the potential change in the value of a financial instrument due to fluctuations in interest and foreign exchange rates and in equity and commodity prices. Market risk is inherent to both derivative and non-derivative financial instruments, and accordingly, the scope of our market risk management extends beyond derivatives to include all market risk sensitive financial instruments. As a financial services company, net interest margin comprises the primary component of the Company's earnings and cash flows. The Company is subject to risk resulting from interest rate fluctuations to the extent that there is a gap between the amount of the Company's interest-earning assets and the amount of interest-bearing liabilities that are prepaid, mature or re-price within specified periods.

The Company monitors the aggregate cash flow, projected net yield and estimated market value of its investment portfolio under various interest rate and prepayment assumptions. While certain investments may perform poorly in an increasing or decreasing interest rate environment, other investments may perform well, and others may not be impacted at all.

The Company focuses on the sensitivity of its investment portfolio cash flow, and measures such sensitivity to changes in interest rates. Changes in interest rates are defined as instantaneous, parallel, and sustained interest rate movements in 100 basis point increments. The Company estimates its interest income cash flow for the next twenty-four months assuming interest rates over such time period follow the forward LIBOR curve (based on 90-day Eurodollar futures contracts) as of September 30, 2006. Once the base case has been estimated, cash flows are projected for each of the defined interest rate scenarios. Those scenario results are then compared against the base case to determine the estimated change to cash flow. Cash flow changes from interest rate swaps, caps, floors or any other derivative instrument are included in this analysis.

The following table summarizes the Company's net interest income cash flow and market value sensitivity analyses at September 30, 2006. These analyses represent management's estimate of the percentage change in net interest margin cash flow and value expressed as a percentage change of shareholders' equity, given a shift in interest rates, as discussed above. Certain investments, with a carrying value of $3.1 million at September 30, 2006 are not considered to be interest rate sensitive and are excluded from the analysis below. The "Base" case represents the interest rate environment as it existed as of September 30, 2006. At September 30, 2006, one-month LIBOR was 5.32% and six-month LIBOR was 5.37%. The base case net interest margin cash flow is $15.1 million, excluding net interest margin on cash and cash equivalents, and $22.2 million, including net interest margin on cash and cash equivalents. The analysis is heavily dependent upon the assumptions used in the model. The effect of changes in future interest rates, the shape of the yield curve or the mix of assets and liabilities may cause actual results to differ significantly from the modeled results. In addition, certain financial instruments provide a degree of "optionality." The most significant option affecting our portfolio is the borrowers' option to prepay the loans. The model applies prepayment rate assumptions representing management's estimate of prepayment activity on a projected basis for each collateral pool in the investment portfolio. The model applies the same prepayment rate assumptions for all five cases indicated below. The extent to which borrowers utilize the ability to exercise their option may cause actual results to significantly differ from the analysis. Furthermore, the projected results assume no additions or subtractions to our portfolio, and no change to Dynex's liability structure. Historically, there have been significant changes in the Company's investment portfolio and the liabilities incurred by the Company. As a result of anticipated prepayments on assets in the investment portfolio, there are likely to be such changes in the future.

	Projected Change in Net Interest Margin Cash Flow From Base Case		
Basis Point Increase (Decrease) in Interest Rates	**Excluding Cash and Cash Equivalents**	**Including Cash and Cash Equivalents**	**Projected Change in Value, Expressed as a Percentage of Shareholders' Equity**
+200	(5.6)%	9.1%	(0.5)%
+100	(1.7)%	5.3%	(0.1)%
Base	-	-	-
-100	0.9%	(5.8)%	0.1%
-200	3.0%	(10.9)%	0.2%

The Company's interest rate rise is related both to the rate of change in short-term interest rates and to the level of short-term interest rates. Approximately $239 million of Dynex's investment portfolio as of September 30, 2006 is comprised of loans or securities that have coupon rates that are fixed. Approximately $110 million of its investment portfolio as of September 30, 2006 was comprised of loans or securities that have coupon rates which adjust over time (subject to certain periodic and lifetime limitations) in conjunction with changes in short-term interest rates. Approximately 67%, 11% and 10% of the adjustable-rate loans underlying our securitized finance receivables are indexed to and reset based upon the level of six-month LIBOR, one-year constant maturity treasury rate (CMT) and prime rate, respectively.

Generally, during a period of rising short-term interest rates, our net interest income earned and the corresponding cash flow on our investment portfolio will decrease. The decrease of the net interest spread results from (i) fixed-rate loans and investments financed with variable-rate debt, (ii) the lag in resets of the adjustable rate loans underlying the adjustable rate securities and securitized finance receivables relative to the rate resets on the associated borrowings and (iii) rate resets on the adjustable rate loans which are generally limited to 1% every six months or 2% every twelve months and subject to lifetime caps, while the associated borrowings have no such limitation. As to item (i), the Company has substantially limited its interest rate risk by match funding fixed rate assets and variable rate assets. As to item (ii) and (iii), as short-term interest rates stabilize and the adjustable-rate loans reset, the net interest margin may be partially restored as the yields on the adjustable-rate loans adjust to market conditions.

Net interest income may increase following a fall in short-term interest rates. This increase may be temporary as the yields on the adjustable-rate loans adjust to the new market conditions after a lag period. The net interest spread may also be increased or decreased by the proceeds or costs of interest rate swap, cap or floor agreements, to the extent that Dynex has entered into such agreements.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the Company's reports filed under the Exchange Act is accumulated and communicated to management, including the Company's management, as appropriate, to allow timely decisions regarding required disclosures.

As of the end of the period covered by this report, the Company carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act. This evaluation was carried out under the supervision and with the participation of the Company's management, including the Company's Principal Executive Officer and Chief Financial Officer. Based upon that evaluation, the Company's management concluded that the Company's disclosure controls and procedures were effective.

In conducting its review of disclosure controls, management concluded that sufficient disclosure controls and procedures did exist to ensure that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

(b) Changes in internal controls.

The Company's management is also responsible for establishing and maintaining adequate internal control over financial reporting. There were no changes in the Company's internal control over financial reporting during the quarter covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal controls.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

As discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, the Company and certain of its subsidiaries are defendants in litigation. The following discussion is the current status of the litigation.

GLS Capital, Inc. (“GLS”), a subsidiary of the Company, and the County of Allegheny, Pennsylvania (“Allegheny County”), are defendants in a lawsuit in the Court of Common Pleas of Allegheny County, Pennsylvania (the “Court”). Plaintiffs allege that GLS illegally charged the taxpayers of Allegheny County certain attorney fees, costs and expenses, and interest in the collection of delinquent property tax receivables owned by GLS. On October 27, 2006, the Court certified the class action status of the litigation, which was originally filed in 1998. In its Order, the Court left open the possible decertification of the class if the fees, costs and expenses charged by GLS are in accordance with public policy considerations as well as the statute and relevant ordinance. The Company may seek to stay this action pending the outcome of other litigation before the Pennsylvania Supreme Court in which GLS is not directly involved but has filed an Amicus brief in support of the defendants. Plaintiffs have not enumerated its damages in this matter, and the Company believes that the ultimate outcome of this litigation will not have a material impact on its financial condition, but may have a material impact on reported results for the particular period presented.

The Company and Dynex Commercial, Inc. (“DCI”), formerly an affiliate of the Company and now known as DCI Commercial, Inc., are appellees (or “respondents”) in the Court of Appeals for the Fifth Judicial District of Texas at Dallas, related to the matter of Basic Capital Management et al (collectively, “BCM” or “the Plaintiffs”) versus Dynex Commercial, Inc. et al. Plaintiff’s appeal seeks to overturn a judgment in favor of the Company and DCI which denied recovery to Plaintiffs, and to have a judgment entered in favor of Plaintiffs based on a jury award for damages against the Company of $253, and against DCI for $2,200 or $25,600, all of which was set aside by the trial court. In the alternative, Plaintiffs are seeking a new trial. The Court of Appeals heard the oral argument on the matter on April 18, 2006 but have not yet issued a ruling on the appeal.

On February 11, 2005, a putative class action complaint alleging violations of the federal securities laws and various state common law claims was filed against Dynex Capital, Inc., our subsidiary MERIT Securities Corporation, Stephen J. Benedetti, the Company's Executive Vice President, and Thomas H. Potts, the Company's former President and a former Director, in United States District Court for the Southern District of New York ("District Court") by the Teamsters Local 445 Freight Division Pension Fund ("Teamsters"). The lawsuit purported to be a class action on behalf of purchasers of MERIT Series 13 securitization financing bonds, which are collateralized by manufactured housing loans. On May 31, 2005, the Teamsters filed an amended class action complaint. The amended complaint dropped all state common law claims but added federal securities claims related to the MERIT Series 12 securitization financing bonds. On July 15, 2005, the defendants moved to dismiss the amended complaint. On February 10, 2006, the District Court dismissed the claims against Messrs. Benedetti and Potts, but did not dismiss the claims against Dynex and MERIT. On February 24, 2006, Dynex and MERIT moved for reconsideration and interlocutory appeal of the District Court's order denying the motion to dismiss Dynex and MERIT. The Company has evaluated the allegations and believes them to be without merit and intends to continue to vigorously defend itself against them.

Although no assurance can be given with respect to the ultimate outcome of the above litigation, the Company believes the resolution of these lawsuits will not have a material effect on our consolidated balance sheet but could materially affect our consolidated results of operations in a given year.

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A - Risk Factors of the Company's Annual Report on Form 10-K for the year ended December 31, 2005 (the “Form 10-K”). The materialization of any risks and uncertainties identified in the Company's Forward Looking Statements contained herein together with those previously disclosed in the Form 10-K or those that are presently unforeseen could result in significant adverse effects on the Company's financial condition, results of operations and cash flows. See Item 2. “Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward Looking Statements” in this Quarterly Report on Form 10-Q.

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

On November 15, 2005, the Company's Board of Directors authorized a common stock repurchase program under which the Company may purchase up to one million shares of its common stock. Subject to the applicable securities laws and the terms of the Series D Preferred Stock designation, future repurchases of common stock will be made at times and in amounts as the Company deems appropriate and may be suspended or discontinued at any time. There were no common stock repurchases made by or on behalf of the Company during the quarter ended September 30, 2006.

Item 3. **Defaults Upon Senior Securities**

None

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

None

Item 5. **Other Information**

None

Item 6. **Exhibits**

10.1	Limited Liability Company Agreement of Copperhead Ventures, LLC dated September 8, 2006 (portions of this exhibit have been omitted pursuant to a request for confidential treatment)
31.1	Certification of Principal Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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.

DYNEX CAPITAL, INC.

Date: November 14, 2006

/s/ Stephen J. Benedetti
Stephen J. Benedetti
Executive Vice President and Chief Operating Officer
(Principal Executive Officer and Principal Financial Officer)

EXHIBIT INDEX

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Exhibit 10.1

CONFIDENTIAL TREATMENT REQUESTED

Confidential material has been separately filed with the Securities and Exchange Commission under an application for confidential treatment. Terms, for which confidential treatment has been requested, have been omitted and marked as redacted.

LIMITED LIABILITY COMPANY AGREEMENT
OF
COPPERHEAD VENTURES, LLC

THIS LIMITED LIABILITY COMPANY AGREEMENT OF COPPERHEAD VENTURES, LLC (this "Agreement") is made as of the 8th day of September, 2006, by and among ISSUED HOLDINGS CAPITAL CORPORATION, a Virginia corporation ("IHCC"), DBAH CAPITAL, LLC, a Delaware limited liability company ("DBAH"), and DARTMOUTH INVESTMENTS, LLP ("Advisors"), a Texas limited liability partnership, which agree to form a limited liability company upon the following terms and conditions:

1. FORMATION AND TERM.

1.1. Formation.

The Company was formed upon the filing of its certificate of formation with the Delaware Secretary of State on July 24, 2006.

1.2. Term.

The term of the Company shall begin on the date of the filing of the certificate of formation and the Company shall continue until dissolved and wound up in accordance with this Agreement.

1.3. Name.

The name of the Company is Copperhead Ventures, LLC. The business of the Company may be conducted under such trade or fictitious names as the Directors may determine.

1.4. Principal Office.

The principal office of the Company, at which the records required to be maintained by the Act are to kept, shall be at 4551 Cox Road, Suite 300, Glen Allen, Virginia, 23060, or such other place as the Directors may determine. The Directors shall give notice to the Members of any change of the principal office.

Registered Agent.
The Company's agent for service of process shall be Capitol Services, Inc. or such other person as the Directors may designate.

2. DEFINITIONS.

The following terms used in this Agreement shall (unless otherwise expressly provided herein or unless the context otherwise requires) have the following respective meanings:

Act.

The Delaware Limited Liability Company Act, as it may be amended or superseded from time to time.

Advisors.

Dartmouth Investments, LLP.

Advisors Note.

The Promissory Note issued by Advisors to the Company as provided in Section 5.2(c).

Affiliate.

When used with reference to a specified Person:

(i) any Person directly or indirectly Controlling, Controlled by, or under common Control with, the specified Person;

(ii) any Person owning or Controlling fifteen percent (15%) or more of the outstanding voting securities of the specified Person;

(iii) any Person that is an officer, director, partner or trustee of, or serves in a similar capacity with respect to the specified Person, or of which the specified Person is an officer, director, partner or trustee; and

(iv) any relative or spouse of the specified Person.

Annual Business Plan.

The annual business plan of the Company described in Section 8.7.

Approved Investment.

An investment approved by the Board as provided in Section 8.3(b)(i).

Auditor.

BDO Seidman LLP or another nationally recognized accounting firm agreed upon by the Board, as provided in Section 8.3(b), to serve as the independent auditors for the Company.

Available Surplus.

All amounts, if any, able to be released to Commercial Capital on a Payment Date from the surplus account for the CCAO Series 2 Trust Collateralized Bonds pursuant to Sections 9(xiii) and (xiv) of the Series 2 Supplement with respect to that Payment Date, other than amounts related to the Series 2 Excluded Assets.

Bankruptcy.

(i) The entry of an order for relief with respect to a Member in proceedings under the United States Bankruptcy Code, as amended or superseded from time to time;

(ii) The filing of an application by a Member for, or its consent to, the appointment of a trustee, receiver or custodian of its assets;

(iii) The making by a Member of a general assignment for the benefit of creditors;

(iv) The entry of an order, judgment or decree by any court of competent jurisdiction appointing a trustee, receiver or custodian of the assets of a Member unless the proceedings and the person appointed are dismissed within ninety (90) days;

(v) The failure by a Member generally to pay its debts as the debts become due within the meaning of Section 303(h)(1) of the United States Bankruptcy Code or the admission in writing of its inability to pay its debts as they become due; or

(vi) A Member's Interest becoming subject to the enforcement of any rights of a creditor of a Member, whether arising out of an attempted charge upon such Member's Interest by judicial process or otherwise, if such Member shall fail to obtain the release of those enforcement rights, whether by legal process, bonding, or otherwise, within ninety (90) days after actual notice of such creditor's action.

Bankrupt Member.

A Member that is the subject of Bankruptcy.

Base Indenture.

The Indenture dated as of November 1, 1993, as amended, between Commercial Capital and the Trustee.

Board.

The Board of Directors described in Section 8.1.

Capital Account.

As of any date, with respect to any Member, the capital account maintained for such Member as determined under Section 5.5.

Capital Contribution.

The total amount of money and the agreed upon fair market value of any property contributed to the Company by a Member or its predecessor in interest on the date of contribution.

Cash Determination Date.

The last day of the six (6) consecutive calendar month period described in Section 7.3.

Cash Percentage.

As of the last day of any calendar month, the percentage of the Company's Net Assets represented by cash, cash equivalents and short term instruments with original maturities of ninety (90) days or fewer.

Cause.

Cause for removal of the Manager as defined in Section 8.6(e).

CCAO Series 2 Trust Collateralized Bonds

The bonds issued by Commercial Capital pursuant to the Base Indenture and the Series 2 Supplement.

CCAO Series 3 Trust Collateralized Bonds

The bonds issued by Commercial Capital pursuant to the Base Indenture and the Series 3 Supplement.

CCAO Series 2 Assets.

The benefits of the Derivative Payments Agreement contributed to the Company by IHCC as described in Sections 5.2(b)(iii).

CCAO Series 3 Assets.

The security and redemption rights contributed to the Company by IHCC as described in Sections 5.2(b)(i) and (ii).

Change in Control Notice.

A notice from IHCC delivered pursuant to Section 15.3.

Change in Control Transaction.

A transaction or series of transactions in which a party that is not an Affiliate of Dynex Capital will acquire more than twenty-five percent (25%) of the voting securities of Dynex Capital to be outstanding after that transaction or series of transactions.

Code.

The United States Internal Revenue Code of 1986, as amended, and any successor statute thereto.

Commercial Capital.

Commercial Capital Access One, Inc., a Virginia corporation, together with its successors and assigns.

Company.

Copperhead Ventures, LLC.

Company Business.

The business of the Company described in Section 4.

Company Minimum Gain.

As of any date, the amount determined under Regulations Sections 1.704-2(b)(2) and 1.704-2(d).

Company Nonrecourse Deductions.

The amount of deductions of the Company calculated under Regulations Section 1.704-2(c).

Company Revenues.

All cash revenue from the operation of the Company Business, interest income received during the year, and reserves set aside in prior years and no longer deemed necessary for the Company Business, as determined by the Board.

Control.

The possession by any person or related group of persons, directly or indirectly, of the power to direct or cause the direction of the management and policies of a Person, whether through ownership of voting securities or partnership interests, by contract or otherwise.

Controlled.

To be under the Control of the specified Person.

Controls or Controlling.

The possession of Control.

DBAH Directors.

The Directors designated by DBAH.

Debt Service.

As the context requires, the amounts, including principal and interest, paid, payable or due with respect to any loans to the Company, or to which the property or assets of the Company are subject.

Derivative Payments Agreement.

The Derivative Payments Agreement in the form of Exhibit B between the Company and IHCC.

Director.

Any individual designated by a Voting Member to serve on the Board.

Disposition.

The sale, assignment, transfer or other disposition, in any manner, whether voluntarily or involuntarily, by operation of law or otherwise.

Dynex Capital

Dynex Capital, Inc., a Virginia corporation.

Dynex Entity.

Each of Dynex Capital, Inc. and its Affiliates.

Dynex Special Withdrawal Notice.

A notice from IHCC delivered pursuant to Sections 15.3(b) or (c).

Election Notice.

A notice delivered by a Non-Withdrawing Member pursuant to Section 13.5(b).

Gain or Loss from Sale.

Any gain or loss for federal income tax purposes resulting from the sale or other disposition of any or all of the Company's assets not in the ordinary course of business, except that for purposes of Capital Account adjustments, such gain or loss shall be computed by reference to the value on the books of the Company (determined in accordance with Regulations Sections 1.704-1(b)(2)(iv)(g) and 1.704-3(d)) as of the date of sale or other disposition rather than by reference to the adjusted tax basis of such property as of that date.

IHCC Directors.

The Directors designated by IHCC.

Interest.

The ownership interest of a Member in the Company at any particular time, including the right of the Member to any and all benefits to which the Member is entitled and the obligations to which the Member is subject under this Agreement. The initial Interests of the Members, expressed as a percentage, are set forth on Exhibit A.

Limited Guaranty

The Guaranty and Indemnification Agreement dated as of October 30, 1997, as defined in the Series 2 Supplement.

Loan Notice.

The notice described in Section 5.3(a)(ii) of a Member's intent to lend to the Company under Section 5.3(a)(i), which shall specify the amount of the proposed loan and the purposes therefor.

Management Fee.

The Management Fee provided for in Section 9.1(b).

Manager.

Dynex Capital or another person designated as manager in accordance with Section 8.6.

Mandatory Excess Cash Distribution.

A distribution required by Section 7.3.

Measuring Date.

See Section 13.5.

Members.

IHCC, DBAH, Advisors and any additions or successors thereto that are admitted as Members.

Member Nonrecourse Debt.

A nonrecourse debt of the Company as described in Regulations Section 1.704-2(b)(4).

Member Nonrecourse Debt Minimum Gain.

As of any date, the amount determined under Regulations Section l.704-2(i)(3).

Member Nonrecourse Deductions.

With respect to a Member Nonrecourse Debt, the items of loss, deduction, and expenditure attributable to such Member Nonrecourse Debt under Regulations Section 1.704-2(i)(2).

Modified Negative Capital Account.

The deficit balance of a Capital Account in excess of the amount of the deficit, if any, a Member is obligated to contribute to the Company under the Agreement or is deemed obligated to restore pursuant to the Code Section 704(b) Regulations.

Net Assets

The total assets of the Company less any loans to the Company, or other obligations of the Company incurred to fund the purchase of investments.

Net Cash from Operations.

For any taxable year, the excess of Company Revenues over the sum of (1) Operating Expenses of the Company paid in cash during the year, (2) Debt Service, (3) the cost of any Approved Investments made during the year plus any reserves established by the Board for the making of Approved Investments, and (4) any reasonable reserves, as determined by the Board or in accordance with the Annual Business Plan, for Operating Expenses in succeeding years, for the repair, replacement or preservation during the current or subsequent years of any Company asset, for Debt Service, or for contingencies and unanticipated obligations.

Net Income or Net Loss.

For each taxable year, the Company's taxable income or taxable loss for such year, as determined under Section 703(a) of the Code, and Regulations Section 1.703-1, but with the following adjustments:

(i) Any tax exempt income, as described in Section 705(a)(1)(B) of the Code, realized by the Company during such year and not otherwise taken into account in computing Net Income or Net Loss shall be included as an item of gross income;

(ii) Any expenditures of the Company described in Section 705(a)(2)(B) of the Code for such Fiscal Year or treated as being so described in Regulations Section 1.704-1(b)(2)(iv)(i) and not otherwise taken into account in this subsection shall be subtracted from such taxable income or taxable loss; and

(iii) Notwithstanding any other provision of this definition, any items that are specially or curatively allocated pursuant to Section 7 shall not be taken into account in computing Net Income or Net Loss.

Net Proceeds from Financing.

Net cash realized by the Company from borrowing by the Company or refinancing of indebtedness of the Company, reduced by (1) all expenses related to the borrowing or refinancing, (2) the amount applied, as determined by the Board, toward the payment of any indebtedness of the Company or other expenditures on behalf of the Company, (3) the cost of any Approved Investments to be made with the proceeds plus any reserves established by the Board for the making of Approved Investments, and (4) reasonable reserves, as determined by the Board, to satisfy other obligations of the Company or anticipated expenditures.

Non-Withdrawing Member.

A Voting Member that receives a Withdrawal Notice.

Operating Expenses.

All costs and expenses of ownership and operation of the Company's assets and the Company Business, including, but not limited to, payroll costs, costs of materials, taxes, insurance premiums, utility costs, costs of repairs and maintenance, costs for general, administrative and overhead, audit expenses, and any other expenses incurred in the ordinary course of operating the Company Business.

<u>Opposing Member</u>.

A Voting Member that receives a Sale Notice as provided in Section 13.7.

<u>Payment Date</u>.

A Payment Date as defined for the purposes of the Series 2 Supplement.

<u>Permitted Transferees</u>.

The Persons described in Section 13.3.

<u>Person</u>.

Any individual, corporation, partnership, limited liability company, firm, joint venture, association, trust or unincorporated organization, a government, or any agency, authority or political subdivision thereof, or any other entity.

<u>Prime Rate</u>.

The annual prime rate (or base rate) reported in the "Money Rates" column or section of <u>The Wall Street Journal</u> as being the base rate on corporate loans at larger U.S. Money Center commercial banks on the first date on which <u>The Wall Street Journal</u> is published in each month. In the event The Wall Street Journal ceases publication of the Prime Rate, then the "Prime Rate" shall mean the "prime rate" or "base rate" announced by Bank of America, N.A. or the successor to substantially all of its assets and business (whether or not such rate has actually been charged by that bank). In the event that bank discontinues the practice of announcing that rate, Prime Rate shall mean the highest rate charged by that bank on short-term, unsecured loans to its most credit-worthy large corporate borrowers.

<u>Proportionate Share</u>.

The share equal to the Member's Interest.

<u>Regulations</u>.

Regulations issued under the Code by the Department of the Treasury, as amended from time to time.

<u>Regulatory Notice</u>.

A notice delivered pursuant to Section 15.4.

Rules.

The American Arbitration Association rules described in Section 20.1.

Sale Notice.

A notice delivered pursuant to Section 13.7.

Selling Member.

A Voting Member that delivers a Sale Notice as provided in Section 13.7.

Series 2 Collateralized Bonds.

CCAO Trust Collateralized Bonds, Series 2, Class E, Class F and Class G.

Series 2 Excluded Assets

Amounts included in and to be distributed to Commercial Capital in accordance with Section 9(xiv) of the Series 2 Supplement that result from the net purchase proceeds received from the purchase of defaulted loans by SunAmerica or its designee pursuant to the Limited Guaranty.

Series 2 Supplement.

Series Supplement dated as of October 1, 1997 to the Base Indenture between Commercial Capital, as Issuer, and the Trustee.

Series 3 Collateralized Bonds.

CCAO Trust Collateralized Bonds, Series 3, Class F, Class G and Class H.

Series 3 Excluded Assets

The Class 3R, representing the residual certificate for pursuant to the Series 3 Supplement, and all accumulated and unpaid interest on the Series 3 Collateralized Bonds.

Series 3 Supplement.

Series Supplement dated as of December 1, 1998 to the Base Indenture between Commercial Capital, as Issuer, and the Trustee.

Trustee.

JPMorgan Chase Bank, National Association (formerly known as The Chase Manhattan Bank and successor by merger to Chase Bank of Texas, National Association (formerly known as Texas Commerce Bank National Association)), as Trustee.

Successor in Interest.

The Person who succeeds to an Interest upon the Bankruptcy of a Member.

United States Bankruptcy Code.

Title 11 of the United States Code, as amended from time to time.

Voting Members.

IHCC and DBAH, and any successor to their Interests that are admitted as Members.

Withdrawal Notice.

A notice of withdrawal delivered pursuant to Section 13.5(a).

Withdrawing Member.

A Voting Member that delivers a Withdrawal Notice.

3. NAME AND PLACE OF BUSINESS.

3.1. Name.

No Member shall have the right to use, and each Member agrees not to use, any trade or service names, marks, emblems or logos owned by or licensed to the Company other than on behalf of the Company.

3.2. Place of Business.

The principal place of business of the Company shall be 4551 Cox Road, Suite 300, Glen Allen, Virginia, 23060, or such other place as the Board may determine.

4. BUSINESS OF COMPANY.

The Company Business shall consist of the ownership and management of a portfolio of residential mortgage backed debt securities, commercial mortgage backed debt securities, asset-backed debt securities, and other similar financial instruments, including derivative securities, and equity securities. The Company will seek to diversify its investments and allocation of the Company's capital. The Company shall not engage in any other business or activity without the mutual consent of the Voting Members, which consent may be withheld in the sole discretion of either Voting Member. Notwithstanding anything contained herein to the contrary, each investment made by the Company must comply with DBAH's Anti-Money Laundering and Compliance requirements (which shall be consistent with the requirements applicable to Affiliates of DBAH), and, unless otherwise approved by DBAH, all securities trading activity by the Company must be completed through a registered broker-dealer.

5. MEMBERS AND CAPITAL CONTRIBUTIONS.

5.1. Members.

Each Member has entered into this Agreement in reliance upon the unique knowledge, experience and expertise of the Voting Members in the development and operation of the Company Business. Accordingly, no Member shall be required to accept performance under this Agreement from any Person other than a Member or a Person to whom a Member is permitted to make a Disposition of its Interest, except as otherwise specifically provided in this Agreement.

5.2. Initial Capital Contributions.

(a) All Capital Contributions shall be made by the close of business on September 15, 2006, to be deemed made effective September 16, 2006.

(b) IHCC will contribute (or cause to be contributed) the following assets to the Company as Capital Contributions:

(i) Its ownership interests in the Series 3 Collateralized Bonds;

(ii) IHCC will cause Commercial Capital to assign its optional right to redeem all of the outstanding CCAO Series 3 Trust Collateralized Bonds; and

(iii) IHCC will deliver an executed copy of the Derivative Payments Agreement with the Company in the form of Exhibit B pursuant to which IHCC will agree to pay to the Company amounts equal to (A) the cash flow received by Commercial Capital with respect to the Available Surplus and (B) the cash flow received by IHCC with respect to the Series 2 Collateralized Bonds.

The Members hereby agree that the IHCC capital contribution pursuant to this Section 5.2 is not intended to include the Series 2 Excluded Assets and the Series 3 Excluded Assets.

The Members agree that the value of the Capital Contributions of IHCC described above are deemed to be Thirty Six Million Five Hundred Thousand Dollars ($36,500,000.00), consisting of [REDACTED PURSUANT TO CONFIDENTIAL TREATMENT REQUEST] with respect to the assets described in subparagraphs (i) and (ii), and [REDACTED PURSUANT TO CONFIDENTIAL TREATMENT REQUEST] with respect to the assets described in subparagraph (iii).

(c) (i)Advisors will contribute $184,000 to the Company as a Capital Contribution in the form of a promissory note in that principal amount (the "Advisors Note") bearing interest at a rate equal to the Prime Rate in the form attached as Exhibit C.

(ii) The Company will forgive the remaining principal balance of the Advisors Note on March 15, 2009; provided that on that date Advisor remains a Member of the Company.

(d) DBAH will contribute to the Company as a Capital Contribution cash in an amount equal to Thirty Six Million Five Hundred Thousand Dollars ($36,500,000.00).

5.3. Additional Capital.

(a) (i)If the Board determines that additional capital, in excess of that which the Members are obligated to contribute to the Company pursuant to Section 5.2, is needed by the Company to avoid a default by the Company with respect to Debt Service or other Company obligations incurred in accordance with this Agreement, to carry out the Business Plan or to protect and preserve the value of the Company's assets or property, the Board shall notify the Members of the additional required capital. A Member may, but shall not be required to, lend money to the Company, which loan shall bear interest at a fluctuating rate equal to two (2) percentage points above the Prime Rate (but in no event at an interest rate higher than the maximum rate legally permitted). Any such loan shall be repaid in full before any distributions are made under Section 7.

(ii)If any Member proposes to lend to the Company under Section 5.3(a)(i), that Member shall give a Loan Notice to the other Members. The other Members shall have the right to lend to the Company their respective Proportionate Shares of the loan amount, by giving notice to the first Member within fifteen (15) days after the Loan Notice is given, and such loan to the Company shall be made within that time period.

5.4. Guaranty of Company Indebtedness.

The Members shall not be obligated to guarantee Company indebtedness unless all Voting Members agree to do so.

5.5. Additional General Provisions on Capital and Obligations of Members.

(a) (i)A Capital Account shall be established and maintained for each Member. A Member shall have a single Capital Account,

(b) regardless of the time or manner in which any portions of the Member's Interest were acquired. If an Interest is transferred in accordance with this Agreement, the transferee shall succeed to the Capital Account of the transferor to the extent it relates to the transferred Interest.

(c) In accordance with Regulations Section 1.704-1(b)(2)(iv), a Member's Capital Account shall consist of (A) the sum of (1) its Capital Contributions, (2) allocations to it of Net Income and Gain from Sale (or items thereof) (other than gain under Section 6.6) including income and gain exempt from tax, and (3) the amount of any Company liabilities assumed by that Member or which are secured by any Company assets distributed to that Member (to the extent of the value of the securing assets), minus (B) the sum of (1) the cash and fair market value of property distributed to it by the Company, (2) the amount of any liabilities of that Member assumed by the Company or secured by any property contributed by that Member to the Company, (3) allocations to it of expenditures of the Company described in Section 705(a)(2)(B) of the Code or treated as such expenditures under the Regulations, and (4) allocations to it of Net Loss and Loss from Sale (or items thereof).

(iii) (A)In accordance with Regulations Section 1.704-1(b)(2)(iv)(f), the book value of the Company's assets shall be revalued and the Capital Account of each Member shall be adjusted to reflect a revaluation of the Company's assets upon the occurrence of the following events:

(1) The contribution of money or other property (other than a de minimis amount) to the Company by a new or existing Member as consideration for an Interest;

(2) The distribution of money or other property (other than a de minimis amount) by the Company to a retiring or continuing Member as consideration for an Interest; or

(3) The liquidation of the Company within the meaning of Regulation Section 1 .704-1(b)(2)(ii)(g).

(B) The adjustment shall be based on the fair market value of Company property (taking Section 7701(g) of the Code into account) on the date of adjustment, and shall reflect the manner in which the unrealized income, gain, loss or deduction inherent in the property (that has not previously been reflected in the Capital Accounts) would have been allocated among the Members if there had been a taxable disposition of the property for fair market value on that date.

(iv) If, pursuant to Regulations Section 1.704-1(b)(2)(iv)(d) or 1.704-1(b)(2)(iv)(f), any Company asset has a book value that differs from the adjusted tax basis of that asset, then the Capital Accounts shall be adjusted in accordance with Regulation Sections 1.704-1(b)(2)(iv)(g) and for allocations of depreciation, depletion, amortization and gain or loss computed for book purposes rather than tax purposes, with respect to such asset.

(v) If there is any basis adjustment pursuant to an election under Section 754 of the Code, then the Capital Accounts shall be adjusted to the extent required by the Regulations.

(vi) The principles in this Agreement governing the adjustments of Capital Accounts are intended to satisfy the capital account maintenance requirements of Regulation Section 1 .704-l(b)(2)(iv) and shall be construed consistently therewith.

(b) No Member gives up any of its rights to be repaid its Capital Contribution in favor of the other Members.

(c) No Member shall be paid interest on its Capital Account.

(d) No Member shall have the right to demand and receive any distribution from the Company in any form other than cash, regardless of the nature of its Capital Contribution.

(e) Except as otherwise provided in this Agreement, no Member shall have the right to demand and receive property of the Company in return of its Capital Contribution or in respect of its Interest until the termination of the Company.

(f) The liability of each Member to the Company or the other Members for the losses, debts, liabilities and obligations of the Company shall be limited to paying its Capital Contributions when due under the Agreement, its share of any undistributed assets of the Company, and (only to the extent required by the Act or other applicable law) any amounts previously distributed to it from the Company.

5.6. No Third Party Beneficiaries.

The foregoing provisions of this Section are not intended to be for the benefit of any creditor or other person to which any debts, liabilities or obligations are owed by (or that otherwise has any claim against) the Company or any of the Members; and no creditor or other person shall obtain any right under any of the foregoing provisions or shall by reason of any of the foregoing provisions make any claim in respect of any debt, liability or obligation (or otherwise) against the Company or any of the Members.

6. ALLOCATIONS.

6.1. Net Income, Net Loss and Credits.

Subject to Sections 6.5 through 6.8, Net Income, Net Loss and tax credits shall be allocated among the Members in proportion to their respective Interests.

6.2. Gain from Sale.

Subject to Sections 6.5 through 6.8, Gain from Sale shall be allocated among the Members in proportion to their respective Interests.

6.3. Loss from Sale.

Subject to Sections 6.6 and 6.8, Loss from Sale shall be allocated among the Members in proportion to their respective Interests.

6.4. Mid-Year Transfers.

In the case of an Interest that has been transferred during the year, unless otherwise agreed by the parties to the transfer:

(a) All Net Income and Loss allocable to the Interest shall be allocated between the transferor and the transferee in the ratio of the number of days in the year before and after the effective date of the transfer without regard to the dates during the year on which income was earned, losses were incurred or Net Cash from Operations was distributed.

(b) Tax credits, if any, shall be allocated among the Members at the time the property with respect to which the credit is claimed is placed in service.

(c) All Gain or Loss from Sale shall be allocated to the holder of the Interest as of the date on which the Company recognizes that Gain or Loss from Sale.

6.5. Minimum Gain Chargeback.

(a) Notwithstanding anything to the contrary in this Agreement, if there is a net decrease in the Company Minimum Gain during a fiscal year, then there shall be allocated to the Members items of Company income and gain in accordance with the Minimum Gain chargeback requirements of Regulations Section 1.704-2(f).

(b) Notwithstanding anything to the contrary in this Agreement, if there is a net decrease in Member Nonrecourse Debt Minimum Gain during a fiscal

(c) year, there shall be allocated to any Member with a share of that Member Nonrecourse Debt Minimum Gain items of income and gain in accordance with the requirements of Regulations Section 1 .704-2(i)(4).

6.6. Allocations to Reflect Book Value/Tax Disparity.

In accordance with Section 704(c) of the Code and the Regulations thereunder, income, gain, loss, and deduction with respect to any property contributed to the capital of the Company shall, solely for tax purposes, be allocated among the Members so as to take into account any variation between the adjusted basis of such property to the Company for federal income tax purposes and its agreed upon fair market value at the time of contribution, such that any unrealized gain or loss associated with such property at the time of the contribution is allocated to the Member that contributed the property; and any additional gain or loss associated with such property is allocated among the Members in accordance with their respective Interests. In addition, if Company property is revalued and the Capital Accounts are adjusted, then subsequent allocations of income, gain, loss and deduction for tax purposes with respect to the revalued property shall take into account the variation between the property's adjusted tax basis and book value in the same manner as under Section 704(c) of the Code and Regulations.

6.7. Qualified Income Offset.

If a Member unexpectedly receives an adjustment, allocation, or distribution described in Regulations Section 1.704-1(b)(2)(ii)(d)(4), (5) or (6) that creates or increases a Modified Negative Capital Account, then items of income or gain (consisting of a pro rata portion of each item of Company income, including gross income and gain for such year) shall be allocated to that Member in an amount and manner sufficient to eliminate, to the extent required by the Regulations, the Modified Negative Capital Account created or increased by the adjustments, allocations or distributions as quickly as possible. For purposes of this Section 6.7, in determining whether a Member has a Modified Negative Capital Account, there shall be taken into account those adjustments, allocations and distributions that, as of the end of the year, are reasonably expected to be made.

6.8. Member Nonrecourse Deductions.

Any Member Nonrecourse Deductions for any fiscal year shall be allocated to the Member who bears the economic risk of loss with respect to the Member Nonrecourse Debt to which such Member Nonrecourse Deductions are attributable in accordance with Regulations Section 1.704-2(i)(1).

DISTRIBUTIONS.

6.9. Net Cash from Operations.

Net Cash from Operations for any year shall be distributed to the Members at such time as the Board shall determine, but not less than annually, in proportion to their respective Interests.

6.10. Net Proceeds from Financing.

Net Proceeds from Financing shall be distributed to the Members (at such time as the Board shall determine) in proportion to their respective Interests.

6.11. Mandatory Excess Cash Distribution.

If for any period greater than six (6) consecutive calendar months beginning with the fourth (4^{th}) calendar month next commencing after the date of this Agreement, the Company's Cash Percentage, as calculated as of the last day of each calendar month for the purposes of Section 9.1(b), exceeds thirty percent (30%), then unless otherwise directed by the Board, the Company shall distribute to the Members within thirty (30) days following the last day of the applicable six (6) consecutive calendar month period (the "Cash Determination Date") an amount of cash sufficient to cause the Cash Percentage to be ten percent (10%) or less as of the Cash Determination Date. Each Mandatory Excess Cash Distribution made pursuant to this Section 7.3 shall be distributed to the Members in proportion to their respective Interests.

6.12. Mid-Year Transfers.

In the case of an Interest that has been transferred during the year, unless otherwise agreed by the parties to the transfer:

(a) Net Cash from Operations shall be distributed to the holder of the Interest on the date of distribution.

(b) Net Proceeds from Financing allocable to the Interest shall be distributed to the holder of the Interest on the date of distribution.

6.13. Outstanding Loans to Company.

Notwithstanding anything to the contrary contained in this Section 7 or in Section 5.2(c) and except as provided below, no distributions shall be made to any Member until all loans, together with interest accrued thereon, owed by that Member to the Company have been repaid in full. Any distribution due to Advisors while any of the principal or interest under the Advisors Note remains outstanding shall be applied first to repay accrued and unpaid interest and then to any unpaid principal of the Advisors Note. Advisors shall not receive any cash distribution until the principal of and any interest accrued on the Advisors Note have been repaid in full.

6.14. Other Payments to Advisors.

(a) The Members will negotiate in good faith with respect to the payment of additional fees to Advisors in the event that Advisors is engaged by the Company to and successfully facilitates the early redemption of the Series 2 Collateralized Bonds and/or the Series 3 Collateralized Bonds. To the extent Advisors does not receive such fees in cash, the Members will negotiate in good faith to adjust the distributions and allocations otherwise provided for in this Section 7 and in Section 6.

(b) Advisors shall receive a one-time fee, payable upon the repayment, maturity, sale or other liquidation of an investment of the Company, equal to one percent (1.0%) of the purchase price of any investment made by the Company that was introduced to the Company by Advisors. The fee payable to Advisors pursuant to this subsection shall only be payable after the Company recovers its basis in such investment plus a profit equal to the one-month London Interbank Offered Rate compounded on a monthly basis from the inception of the investment.

7. MANAGEMENT.

7.1. Board of Directors.

(a) The Company Business shall be managed by a Board that shall consist initially of two Directors, with the Voting Members each having the right to designate one Director.

(b) The Board shall, subject to the approval rights and other requirements in Section 4 and the approval rights reserved to the Voting Members in Sections 5.4, 16 and 17, and subject to Section 8.8, have exclusive authority and full discretion with respect to the management of the Company Business.

(c) The Board shall act by resolution duly adopted at a meeting of the Board or by consent in writing of all Directors. Directors may vote or give their consent in person or by proxy.

(d) No action may be taken by the Board without the affirmative vote of at least two Directors.

7.2. Appointment and Removal of Directors.

(a) Each Voting Member shall promptly designate its Director so that the Board shall at all times consist of two Directors.

(b) Either Voting Member may at any time, by notice to the other Members, remove any or all of its Directors, with or without cause, and substitute new Directors to serve in their stead. No Director shall be removed from office, with or without cause, without the consent of the Voting Member that designated him.

(c) If any Director is unwilling or unable to serve or is removed from office by the Voting Member that designated him, the Voting Member that designated him shall designate the successor to that Director.

(d) The notice of a Voting Member appointing a Director shall in each case set forth that Director's business and residence addresses and business telephone number.

(e) Each Voting Member shall promptly give notice to the other Voting Member of any change in the business or residence address or business telephone number of any of its Directors.

7.3. <u>Exercise of Authority Granted to the Board</u>.

(a) Subject to the limitations of Section 8.3(b), the Board may delegate such general or specific authority to the officers of the Company as it from time to time considers desirable, and the officers of the Company may, subject to any restraints or limitations imposed by the Board, exercise the authority granted to them.

(b) Notwithstanding anything contained herein to the contrary, the authority to determine the following matters with respect to the Company shall be retained by the Board (subject to Section 8.6) and any action with respect thereto may be taken by the officers of the Company (within such general or specific limits as may be determined by the Board) only after the Board has approved the action in question in accordance with this Section:

(i) Investing the assets of the Company (provided that the Manager may invest assets of the Company in short term instruments with original maturities of ninety (90) days or fewer and that are rated the equivalent of AAA by two of the three national ratings agencies, without the approval of the Board);

(ii) Take any action that would have the effect of causing the Company not to cause the redemption of the CCAO Series 3 Trust Collateralized Bonds issued pursuant to the Series 3 Supplement in February 2009;

(iii) Appointing or removing the Manager, subject to Section 8.6(e);

(iv) Determining the amount and necessity for loans pursuant to Section 5.3(a);

(v) Determining the amount and timing of distributions to the Members;

(vi) Entering into any transaction between the Company and any Member or any Affiliate of a Member, other than a loan pursuant to Section 5.3(a);

(vii) Acquiring or starting up any new business activity within the Company Business;

(viii) Except as provided in Section 5.3(a), borrowing money, other than trade debt in the ordinary course of the Company Business or as provided for in the Annual Business Plan then in effect;

(ix) Pledging, placing in trust, assigning or otherwise encumbering any existing property, now owned or hereafter acquired by the Company, excluding accounts receivable from trade creditors, as collateral or security for any borrowing or other obligation of the Company, except for pledges or deposits under workmen's compensation, unemployment insurance and social security laws or to secure the performance of bids, tenders, contracts (other than for the repayment of money), or leases, or to secure statutory obligations or surety or appeal bonds or to secure indemnity, performance or similar bonds used in the ordinary course of business;

(x) Selling or otherwise disposing of, or contracting to sell or otherwise dispose of, any of the Company's assets in any one transaction or in any series of transactions out of the ordinary course of the Company Business, other than as contemplated by the Annual Business Plan then in effect;

(xi) Causing the Company to be merged, pooled or combined with any other business or enterprise;

(xii) Adopting overall financial policies for the Company including, without limitation, adopting or changing significant tax or accounting principles or policies, adopting the initial and subsequent Annual Business Plans or any amendments thereto, or any change in the amount of any reserves to be maintained by the Company;

(xiii) Assuming, guaranteeing (other than credit card obligations for employees), endorsing or otherwise becoming liable for the obligations of any Person except by endorsement for purposes of discount or collection of notes or other instruments received by the Company from customers in the ordinary course of business;

(xiv) Commencing or entering into the resolution of any actual or threatened litigation involving the Company with respect to which the aggregate amount in controversy exceeds $10,000 or that is otherwise material or seeking injunctive relief against or on behalf of the Company;

(xv) Making loans or advances to any party, excluding advances for travel expenses;

(xvi) Entering into any contract or commitment obligating the Company to make aggregate expenditures of more than $25,000;

(xvii) Dissolving the Company except as otherwise provided in Section 14.1(a)(i);

(xviii) Selecting or changing the Auditor;

(xix) Changing the fiscal year of the Company or any accounting policy or procedure of the Company, except as required by law;

(xx) Entering into any collective bargaining agreement;

(xxi) Amending or modifying any contract, agreement or arrangement required to be approved by the Board pursuant to this Section 8.2(b);

(xxii) Declaring bankruptcy of the Company; and

(xxiii) Making any other decision material to the Company's operations, management, business or financial condition.

7.4. Chairman of the Board.

(a) The Chairman of the Board, who shall be one of the Directors, shall be selected by each Voting Member on a rotating basis for a one (1) year term. The initial Chairman of the Board shall be designated by DBAH.

(b) The Chairman of the Board shall preside at Board meetings.

7.5. Meetings of the Board.

(a) The Directors shall hold not less than four (4) regular meetings each year on such dates and at such times as may be designated by the Board.

(b) Special meetings of the Board may be held at any time, upon call of the Manager or any Director.

(c) Unless waived in writing by all of the Directors (before or after a meeting), at least two (2) business days' prior notice of any meeting shall

(d) be given to each Director. Such notice shall, in the case of a special meeting, state the purpose for which such meeting has been called. No business can be conducted or action taken at such meeting that is not provided for in such notice. Except as otherwise determined by the Board, the locations of all meetings of the Board shall be alternated between locations within the United States (unless otherwise agreed by the Voting Members) designated by each Voting Member. Meetings of the Board shall be conducted in accordance with Roberts Rules of Order.

(e) A quorum for any meeting of the Board shall be at least two (2) of the Directors then in office.

(f) The Board shall cause to be kept a book of minutes of all of its meetings in which there shall be recorded the time and place of such meeting, whether regular or special, and if special, by whom such meeting was called, the notice thereof given, the names of those present, and the proceedings thereof. Copies of any consents in writing shall also be filed in such minute book.

(g) Members of the Board may participate in a meeting of the Board by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and such participation shall constitute presence in person at such meeting. Either Voting Member may permit its employees or employees of its Affiliates to attend Board meetings as non-voting observers.

7.6. Manager.

(a) The Manager shall act as agent of the Company and shall have such powers as are usually exercised by officers of a Delaware corporation and shall have the power to bind the Company through the exercise of such powers, to the extent consistent with the terms hereof.

(b) The initial Manager of the Company shall be Dynex Capital.

(c) Unless the Board otherwise approves as provided in Section 8.3(b)(ii), the Manager shall take all actions necessary to cause the Company to exercise the rights assigned to it by Commercial Capital to redeem the CCAO Series 3 Assets in February 2009 in accordance with the terms of the Base Indenture and the Series 3 Supplement or any other documents governing those securities.

(d) Unless the Board otherwise directs, the Manager shall take all actions necessary to enforce, on behalf of the Company, the obligation of IHCC under the Derivative Payments Agreement to cause the redemption of the CCAO Series 2 Trust Collateralized Bonds at the earliest possible date that those bonds may be redeemed.

(e) The Manager may be removed for "Cause" (as defined below) by either Voting Member, by the DBAH Directors or by the IHCC Directors. In the event of removal, a new Manager reasonably acceptable to each Voting Member shall be appointed by the Board. There shall be Cause to remove the Manager if the Manager or any Affiliate of the Manager: (i) intentionally engages in dishonest conduct in connection with the Manager's performance of services for the Company; (ii) is convicted of, or pleads guilty or *nolo contendere* to, a felony or any crime involving moral turpitude; (iii) willfully fails or refuses to perform the Manager's material obligations under any agreement with the Company; (iv) breaches in any material respect any fiduciary duties to the Company; or (v) willfully breaches or violates in a material respect any law, rule or regulation in connection with the Manager's performance of services for the Company.

7.7. Annual Business Plan.

(a) The Manager shall, on or before December 31 of each year, propose an annual budget (collectively, the “Annual Business Plan”) for the Company for the next fiscal year and submit that budget to the Board for its approval. The budget shall include a profit and loss statement, a cash flow statement and a balance sheet for the next fiscal year, as of year end, and proposals for deployment of the Company's assets.

(b) The Board shall consider the adoption of the Annual Business Plan at a meeting called for that purpose and may modify or adjust the Annual Business Plan or any aspect thereof in such manner as it deems appropriate. The Company Business shall be carried on in accordance with the Annual Business Plan as adopted by the Board.

7.8. Limitation on Other Members’ Powers.

Except for designating and removing Directors pursuant to Sections 8.1(a) and 8.2, adopting a plan of liquidation and directing the Manager in winding up the affairs of the Company after the dissolution of the Company pursuant to Section 14.1(a)(i), as provided in Section 15.2, and executing certificates and amendments thereof as described in Section 19; no Member acting alone shall, without the consent of the Voting Members, have any right or authority, either express or implied, to act for or bind the Company.

7.9. Execution of Documents.

(a) Any deed, deed of trust, bill of sale, lease agreement, security agreement, financing statement, contract of sale or other contract or instrument purporting to bind the Company or to convey or encumber any of the assets of the Company in the ordinary course of business, may be signed by Stephen J. Benedetti in his capacity as an executive officer of the Manager, or by another executive officer of the Manager, after obtaining

(b) the approval required by this Agreement, and no other signature shall be required. For the purposes of this Agreement, "executive officer" shall have the same meaning given that term under Rule 3b-7 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934.

(c) Any Person dealing with the Company shall be entitled to rely on a certificate of the Manager, as conclusive evidence of the incumbency of the Manager and its authority to take action on behalf of the Company and shall be entitled to rely on a copy of any resolution or other action taken by the Board and certified by the Manager, as conclusive evidence of such action and of the authority of the Manager to bind the Company to the extent set forth therein.

8. COMPENSATION AND REIMBURSEMENT OF MEMBERS.

8.1. Compensation of Members.

(a) Except as provided in Section 10 or as the Board may otherwise determine, no Member shall receive any compensation for its services to the Company.

(b) If the Manager is a Member or an Affiliate of any Member, the Manager will not be entitled to receive any compensation from the Company for its services. If the Manager is not a Member or an Affiliate of a Member, the Manager will be entitled to receive from the Company a quarterly Management Fee equal to 0.017% of the value of the Net Assets in the Company's portfolio as of the last business day of each calendar quarter. The Company shall pay the Management Fee for the preceding calendar quarter to the Manager not later than the tenth (10^{th}) day of each calendar quarter. The value of the Net Assets in the Company's portfolio as of the last business day of each calendar quarter shall be determined by reference to the financial statements of the Company prepared in accordance with generally accepted accounting principles.

8.2. Reimbursement Restrictions.

(a) No Member shall, without Board approval, be entitled to be reimbursed for any expenses incurred by that Member in its capacity as Member including, without limitation, direct out-of-pocket expenses, overhead or administrative expenses or any allocated expenses of employees or staff.

(b) Except with respect to travel and related expenses incurred by the Directors in conjunction with attendance at meetings of the Board, no compensation of, or expenses incurred by, the Directors incident to their duties and responsibilities as Directors (as contrasted with expenses incurred by the Manager) under this Agreement shall be paid by, or charged to, the Company.

(c) AUTHORITY OF THE MEMBERS AND AFFILIATES TO DEAL WITH THE COMPANY, COMPETE WITH THE COMPANY AND COMPETE WITH EACH OTHER.

8.3. General Authority.

The Company may, in the Board's discretion, (a) engage any Person in which any Member, or any Affiliate of a Member, may have an interest, for the performance of any and all services or purchase of goods or other property that may at time be necessary, proper, convenient, or advisable in carrying on the Company Business, or (b) transact the Company Business with, or sell or all of the Company's assets to, any Person in which a Member, or any Affiliate, may have an interest if the compensation or price therefor does not materially and adversely differ from that prevailing in arm's length transactions by others rendering or receiving similar services or purchasing similar goods or other property in comparable transactions as an on-going activity in the same geographical area where such business is transacted.

8.4. Competition with the Company.

(a) Except as expressly limited by this Section 10.2(a), any of the Members and any Affiliate of a Member may engage in and possess an interest in any business venture of any nature and description, independently or with others; and neither the Company nor the other Members shall, except as otherwise provided in this Section 10.2(a), have any right by virtue of this Agreement in and to any such independent ventures or to the income or profits derived therefrom. Neither a Member nor any Affiliate of a Member shall be obligated to present any particular investment opportunity to the Company even if such opportunity is of a character which, if presented to the Company, could be taken by the Company, and each of them shall have the right to take for its own account (individually or as a trustee) or to recommend to others any such particular investment opportunity.

(b) Notwithstanding the provisions of Section 10.2(a), Advisors shall not intentionally engage in willful misconduct that Advisors reasonably knows or should know will have a material adverse effect on the Company or its business, operations or reputation.

8.5. Redemption of Bonds.

No Member will take, and each Member will use reasonable efforts to cause its Affiliates not to take, any action that would impair the ability of the Company to redeem the Series 2 Collaterized Bonds and/or the Series 3 Collaterized Bonds.

8.6. Bank Accounts.

All funds of the Company shall be deposited in accounts of the Company at such financial institutions as the Board may designate. Withdrawals from any such account shall be made only in the regular course of the Company Business. All withdrawals shall be made upon the signature of such individual or individuals as the Board shall designate.

8.7. Maintenance of Books.

The Company shall keep or cause to be kept complete and accurate books of account, in which shall be entered fully and accurately each and every transaction of the Company. The Company's books shall be maintained at the principal place of business of the Company or at such other place as the Board may from time to time designate; and each Member shall have access to the books at all reasonable times and the right to inspect and copy such books either directly or through a person designated by it.

8.8. Method of Accounting.

All books and records of the Company shall be kept in accordance with generally accepted accounting principles, with such exceptions as the Board may determine from time to time, with an annual accounting period ending in December, except for the final accounting period, which shall end on the date of termination of the Company. Any reference in this Agreement to a "fiscal year" shall be to such annual accounting period.

8.9. Financial Reports.

(a) The Company shall prepare or cause to be prepared and shall provide to each Member, within ten (10) business days after the end of each month, a statement of profit and loss, a cash flow statement for such month showing variations from the budgeted amount for such month and the year to date, and a balance sheet as of the end of such month, all on a consolidated basis and separately for each reporting unit.

(b) The Company shall also cause to be prepared and shall send to each Member within ninety (90) days after the end of each fiscal year, audited financial statements and a statement of profit and loss approved by the Auditors.

(c) In addition, the Company shall cause to be prepared and shall send to each Member within ninety (90) days after the end of each fiscal year, a report stating each Member's distributive share of each class of income, gain, loss or deduction, including tax preference items, for the year.

(d) Tax Returns and Information.

(e) It is intended that the Company be characterized and treated as a partnership for, and solely for, federal, state and local income tax purposes. For such purpose, the Company shall be subject to all of the provisions of subchapter K of chapter 1 of subtitle A of the Code, and all references to a "Partner," to "Partners" and to the "Partnership" in the provisions of the Code and Regulations cited in this Agreement shall be deemed to refer to a Member, the Members and the Company, respectively.

(f) The Company shall cause to be prepared and timely filed annually the federal, state and local tax returns of the Company. Drafts of the tax returns shall be submitted to each Member for review at least thirty (30) days before the earlier of (a) the proposed filing date or (b) the due date for filing, including extensions that have been granted. The Company shall cause to be delivered to each Member (i) the tax information required to enable the Members to prepare and file their tax returns in a timely manner, and (ii) copies of all tax returns and amendments thereto filed by the Company.

8.10. Tax Matters Partner.

(a) IHCC is designated as the Tax Matters Partner for purposes of the Code.

(b) (i)The Tax Matters Partner shall keep the other Members informed of all administrative and judicial proceedings and shall promptly provide the other Members with copies of all notices and other communications to and from the Internal Revenue Service or other federal, state or local administrative agency pertaining to any tax or similar return filed by the Company.

(ii) The Tax Matters Partner shall promptly give notice to the other Members of the time and place of meetings with representatives of the Internal Revenue Service or other federal, state or local administrative agency pertaining to any tax or similar return filed by the Company, and DBAH shall be given the opportunity to have a representative attend any such meeting.

(iii) If any matter concerning the Company is in litigation, the Tax Matters Partner shall keep the other Members informed of the progress of the litigation and shall afford DBAH, through its representative, the opportunity to attend all meetings and hearings pertaining to such litigation.

(iv) The Tax Matters Partner shall provide the other Members with copies of all pleadings, notices or other material documents or communications relating to such litigation.

(v) Notwithstanding any right or power that may be granted to the Tax Matters Partner under the Code or any other provision of law, the Tax Matters Partner shall not, without the approval of the Board or an individual designated by each Voting Member for such purpose:

(vi) extend the statute of limitations on behalf of the Company;

(vii) determine the Company's choice of the forum for the litigation of any matter pertaining to the treatment of items of income, deduction or credit;

(viii) determine whether to appeal or not appeal any administrative or judicial determination;

(ix) enter into any settlement agreement with the Internal Revenue Service which purports to bind a Member other than the Tax Matters Partner; or

(x) file any request for an administrative adjustment under Section 6227 of the Code.

8.11. Fair Value Information.

From time to time upon request by the Manager, DBAH will use reasonable efforts to provide the Company with information regarding the fair market value of the assets of the Company.

9. EXCULPATION AND INDEMNIFICATION OF THE MEMBERS.

9.1. Exculpation.

No Member or Manager, nor any Director of the Company, shall be liable to the Company or to any Member for or as a result of any act, omission or error in judgment that was taken, omitted or made by it in the exercise of its judgment in good faith pursuant to the authorization granted to it under this Agreement or delegated to it pursuant to this Agreement that does not constitute gross negligence, willful misconduct or a knowing violation of law, or a transaction from which the Member, Manager or Director derived an improper personal benefit.

9.2. General Indemnification.

(a) To the extent that a corporation is permitted to indemnify its directors under the Delaware General Corporation Law, the Company shall indemnify and hold harmless the Members, the Manager and the Directors from and against all costs, loss, damage and expense, including reasonable attorney's fees, arising out of or resulting from any act performed by such Member, Manager or Director, within the scope of the authority conferred

(b) upon it by this Agreement or delegated to it pursuant to this Agreement, except for (i) acts of gross negligence, fraud, willful misconduct or knowing violations of law by such Member, Manager or Director, or (ii) damages arising from a transaction from which such Member, Manager or Director derived an improper personal benefit.

(c) Each Member shall indemnify and hold harmless the Company and the other Members from and against all costs, loss, damage and expense, including reasonable attorney's fees, arising out of or resulting from any act performed by the indemnifying Member beyond the scope of authority conferred upon the indemnifying Member by this Agreement or by reason of any act of fraud, bad faith, gross negligence, willful misconduct, knowing violation of law, or arising from a transaction from which the Member derived an improper personal benefit.

10. TRANSFER OF INTERESTS AND WITHDRAWAL.

10.1. No Right to Resign or Withdraw.

Except as provided below, no Member shall have any right to voluntarily resign or otherwise withdraw from the Company without the written consent of all Voting Members.

10.2. Transfer of Interest.

No Member shall, directly or indirectly, make a Disposition of all or any part of the Interest now owned or subsequently acquired by it, other than as provided in this Agreement. Any Disposition without full compliance with this Agreement shall be void.

10.3. Permitted Transfers.

(a) Notwithstanding the above, a Member may transfer all or any portion of its Interest at any time to any of the following (the "Permitted Transferees"):

(i) Other Members (subject to Section 13.4 with respect to the Interest of Advisors);

(ii) A Member's Affiliate.

Provided, however, that the transferee, as a condition of becoming a Permitted Transferee, expressly consents in writing to be bound by all the terms and conditions of this Agreement then in effect; and provided further that no Permitted Transferee shall become a substitute Member without compliance with the terms of Section 13.6.

Notwithstanding the provisions of Section 13.3(a), no Member may sell or exchange more than twenty five percent (25%) of its Interest within any twelve (12) month period unless either (i) the selling or exchanging Member obtains the prior written consent of the Voting Members or (ii) in the opinion of counsel for the Company, if Section 708 of the Code applies to such a sale or exchange, then the effects of Section 708 of the Code would not have a substantial adverse effect on the other Members. Moreover, no Disposition by any Member may be made if the Disposition (either considered alone or in the aggregate with prior Dispositions by other Members) would result in the Company being classified as a "publicly traded partnership" within the meaning of Section 7704(b) of the Code.

(b) For the purposes of this Agreement, if a Voting Member transfers all or any portion of its Interest to a Permitted Transferee, and the Permitted Transferee is admitted as a substitute Member pursuant to Section 13.5, then all references to a Voting Member or Voting Members in this Agreement shall be deemed to refer collectively to such Voting Member and its Permitted Transferees that have become Members. For the purposes of any action to be taken or vote or approval to be made or given under this Agreement, an action shall be deemed to have been taken, vote shall be deemed to have been made, and/or approval deemed to have been given or withheld if such vote, action or approval (or withholding of approval) is authorized by a majority in Interest of the Members comprising that Voting Member.

10.4. Disposition by Advisors.

(a) Except as provided in this Section 13.4, Advisors shall have no right to voluntarily resign or otherwise withdraw from the Company without the written consent of all Voting Members, and may not make a Disposition of all or any part of the Interest now or subsequently acquired by it other than to a Permitted Transferee.

(b) If Advisors desires to transfer all or any portion of its Interest to a Voting Member that has agreed to purchase all or a portion of that Interest, Advisors may transfer that Interest only after first offering the Interest to the other Voting Member by providing the other Voting Member a notice that includes a copy of the agreement to purchase the Interest with the purchasing Voting Member. This notice shall specify the portion of the Interest proposed to be purchased by the other Voting Member, the proposed price for the Interest and the other terms of the proposed transfer. Within sixty (60) days following this notice, the other Voting Member shall have the right to purchase its pro rata share of the Interest being sold by Advisors. The purchase price for such Interest shall be the proportionate amount of the price offered to be paid by the other Voting Member, and the other terms of the purchase shall be identical to the terms agreed to with the other Voting Member.

(c) Advisors shall have the right, exercisable by written notice to the Company, to request that the Company redeem its Interest, which request may be acted upon by the Company in its sole discretion, at a purchase price equal to the amount of Advisors' Capital Contribution or such other purchase price as may be mutually agreed to by Advisors and the Company.

10.5. Withdrawal by Voting Member.

(a) A Voting Member may elect to withdraw from the Company by giving a Withdrawal Notice to the other Voting Members during the term of this Agreement. Upon the receipt of a Withdrawal Notice, the other Voting Members shall be entitled to take any of the following actions (which shall not be deemed applicable to a Change in Control Notice, Dynex Special Withdrawal Notice or Regulatory Notice):

(i) Elect the dissolution of the Company as provided in Section 15.1;

(ii) Cause the Company to redeem the Interest of the Withdrawing Member as provided in this Section 13.5; or

(iii) Purchase the interest of the Withdrawing Member as provided in this Section 13.5.

(b) Upon receipt of a Withdrawal Notice, the Non-Withdrawing Member shall deliver an Election Notice to the Withdrawing Member within thirty (30) days following receipt of the Withdrawal Notice, specifying the election it has made pursuant to Section 13.5(a).

(c) If the Non-Withdrawing Member has elected to cause the dissolution of the Company, then the Company shall be dissolved as provided in Section 15.1(b), provided that the distribution to be received by the Withdrawing Member pursuant to Section 15.1(b) shall be reduced by ten percent (10%) if the Withdrawal Notice is given on or prior to September 15, 2007, and shall be reduced by four percent (4%) if the Withdrawal Notice is given on or prior to September 15, 2008. If the Non-Withdrawing Member elects to cause the Company to redeem the Interest of the Withdrawing Member or to purchase the Interest of the Withdrawing Member, then the redemption or purchase shall take place in accordance with provisions of Section 13.5(d).

(d) (i)Closing for the Purchase of a Withdrawing Member's Interest shall take place within thirty (30) days following the date of delivery of the Withdrawal Notice; provided, however, that if the Election Notice includes a statement to the effect that the Company or the Non-Withdrawing Member requires financing in order to complete the redemption or purchase of the Withdrawing Member's Interest, the Non-Withdrawing Member shall have the option to postpone

(e) the closing for the redemption or purchase of the Non-Withdrawing Member’s Interest until a date that is no later than ninety (90) days following the date of the Withdrawal Notice, unless the Withdrawal Notice contained an offer by the Withdrawing Member to finance the redemption or purchase of the Withdrawing Member’s Interest that complies with the terms described in Section 13.5(e). Unless the Voting Members agree otherwise, if the Non-Withdrawing Member or the Company, as the case may be, is unable to obtain financing within the ninety (90) day period following the Withdrawal Notice, the Company shall be dissolved in accordance with Section 15.

(i) The purchase price for the redemption or purchase of the Withdrawing Member’s Interest shall be such price as is mutually agreed to by the Withdrawing Member and the Non-Withdrawing Member. If the Withdrawing Member and the Non-Withdrawing Member cannot mutually agree upon the purchase price within ten (10) business days after receipt of the Election Notice by the Withdrawing Member, the purchase price shall be the lower of (A) the value of the Capital Account of the Withdrawing Member as of the last day of the calendar month next preceding the date of closing (the "Measuring Date"), or (B) as of the Measuring Date, the Withdrawing Member’s Proportionate Share multiplied by (x) the amount of cash and cash equivalents of the Company, plus (y) the fair market value of the assets of the Company other than cash and cash equivalents, which shall be determined by obtaining a third party valuations from a qualified investment banker that is not an Affiliate of any Member for each of the assets of the Company other than cash or cash equivalents. If the Withdrawing Member and the Non-Withdrawing Member cannot agree on the investment banker selected to provide the valuations, then each of them shall select a qualified investment banker that is not an Affiliate of any Member to provide the valuations. If the higher aggregate valuation amount for the assets of the Company received from one of the investment bankers is no more than ten percent (10%) greater than the aggregate valuation amount received from the second investment banker, then the aggregate valuation amount shall be deemed to be the average of the aggregate valuation amounts received from the two investment bankers. However, if the higher aggregate valuation amount exceeds the lesser aggregate valuation amount by more than ten percent (10%), then the two investment bankers shall jointly select a third investment banker to provide valuations. If the aggregate valuation amount provided by the third investment banker is between the aggregate valuation amounts provided by the other two investment bankers, then the aggregate valuation amount shall be deemed to be the aggregate valuation amount provided by the third appraiser. If the aggregate

(ii) valuation amount provided by the third appraiser is greater than the highest aggregate valuation amount provided by the first two appraisers, or less than the lowest aggregate valuation amount provided by the first two appraisers, then the aggregate valuation amount shall be deemed to be the aggregate valuation amount received from the one of the first two appraisers whose aggregate valuation amount is closest to the aggregate valuation amount provided by the third appraiser. The aggregate valuation amount shall be adjusted for any applicable discount as provided in the next sentence. Any valuation of the assets of the Company shall be discounted by ten percent (10%) if the Withdrawal Notice is delivered on or prior to the first anniversary of the date of this Agreement, and shall be discounted by four percent (4%) if the Withdrawal Notice is delivered after the first anniversary of the date of this Agreement but on or prior to the second anniversary of the date of this Agreement.

(f) If the Withdrawing Member has provided in the Withdrawal Notice that it is willing to finance the purchase or redemption of its Interest, then such financing shall satisfy the condition provided for in Section 13.5(d) if the financing provides for a term of not less than one year and interest rates consistent with the interest costs made available to a typical counterparty of DBAH's Affiliates under reverse repurchase agreements.

10.6. Additional or Substituted Member.

(a) A transferee of a Member's Interest may become an additional or substituted Member in place of its transferor only if all of the following conditions are satisfied:

(i) The requirements of Section 13.3 have been fulfilled.

(ii) The instrument of assignment sets forth the intention of the assignor that the assignee shall succeed to the assignor's Interest as an additional or substituted Member.

(iii) The assignor and assignee shall have executed such other instruments as the Board may reasonably require, including written acceptance by the assignee of this Agreement and any ancillary agreements to which the Members are parties.

(iv) The assignee shall have paid all reasonable fees and costs incurred by the Company in connection with its addition or substitution as a Member as determined by the Board, including all costs of amending this Agreement and any ancillary agreements to which the Members are parties in order to accommodate the assignee's addition or substitution as a Member.

(v) Unless named in this Agreement or admitted to the Company as provided in Sections 13.6, 14.1(a)(iii), or 16, no Person shall be considered a Member, and the Company, each Member, and any other Person having business with the Company need deal only with Members so named and so admitted. Neither the Company, another Member or any other Person having business with the Company shall be required to deal with any other Person by reason of any Disposition by a Member or by reason of the dissolution of a Member, except as otherwise provided in this Agreement. In the absence of substitution of a Member for an assigning or dissolved Member, any payment to such Member, or to its successors, shall release the Company of all liability to any other Person who may be interested in such payment by reason of an assignment by the Member or by reason of its dissolution.

10.7. <u>Deadlock Regarding a Sale of Assets</u>.

At any time after good faith efforts fail to resolve a deadlock of the Board or Voting Members that has a duration of at least ninety (90) days, measured from the date of the meeting of the Board at which the deadlock first occurred, with respect to the sale of any asset of the Company in which the Company has a basis of at least $10 million (except with respect to any of the CCAO Series 2 Assets, including any rights of the Company under the Derivative Payments Agreement, or the CCAO Series 3 Assets), the Voting Member that is in favor of the sale of the asset (the "Selling Member") shall have the right to cause the Company to offer, by written notice (a "Sale Notice") to the Voting Member opposing such sale (the "Opposing Member"), to sell the asset to the Opposing Member at the price specified in the Sale Notice. The Opposing Member may elect, by written notice to the Company within ten (10) business days after the Opposing Member receives the Sale Notice, to purchase the asset at the price specified in the Sale Notice, and the Opposing Member shall have thirty (30) days to complete such purchase. If the Opposing Member does not notify the Company of its election to purchase the asset or fails to complete the purchase of the asset within the time periods prescribed above, then the Selling Member shall have the right, for a period of ten (10) business days after the deadline for the Opposing Member to provide notice of its intent to purchase the asset or to complete the purchase of such asset, as the case may be, to cause the Company to sell the asset to a third party purchaser at a sale price equal to or greater than the price specified in the Sale Notice. If the sale to such third party is not completed within ten (10) business days after the Selling Member acquires the right to cause the Company to sell the asset to a third party, then the Company shall not sell such asset unless it first re-offers to sell the asset to the Opposing Member in accordance with the procedures specified above.

Company Right to Purchase Advisors Interest.

(a) Advisors hereby grants to the Company the right to purchase, at the Company's option, the Interest held by Advisors if Advisors or any of its Affiliates (i) intentionally engages in willful misconduct that Advisors reasonably knew or should have known would have a material adverse effect on the Company or its business, operations or reputation or (ii) is convicted of, or pleads guilty or *nolo contendere* to, a felony or any crime involving moral turpitude.

(b) The Company may exercise the foregoing right to purchase by giving notice to Advisors within 60 days after the occurrence of one of the events specified above. Such notice shall set forth the date, time and place for the closing of such purchase. The purchase price for such Interest shall be the lesser of (i) the value of the Capital Account of Advisors as of the date the Company provides such notice to Advisors or (ii) the remaining principal balance of the Advisors Note.

11. <u>CONTINUATION OF THE COMPANY BUSINESS IN CERTAIN EVENTS</u>.

11.1. <u>Bankruptcy</u>.

(a) (i)Upon the Bankruptcy of a Member, the other Voting Member or Voting Members shall have the option either to (A) purchase not less than all of the Interest of the Bankrupt Member and its Affiliates, at a price determined pursuant to Section 14.1(b), (B) dissolve the Company, or (C) continue the business of the Company and allow the Successor in Interest to the Bankrupt Member to become a Member. The option shall be exercised by giving notice to the Bankrupt Member and its Successor in Interest within ninety (90) days after the determination of value under Section 14.1(b).

(ii) If the option to purchase is exercised, closing shall be within thirty (30) days after the giving of notice of exercise or lifting of the automatic stay, whichever is later. If the option to purchase is exercised, the business of the Company shall be continued without winding up the Company's affairs.

(iii) If the non-Bankrupt Member does not elect to dissolve the Company, the business of the Company shall continue without winding up the Company's affairs, and the Successor in Interest to the Bankrupt Member shall become a Member with all the benefits and obligations of its predecessor in interest and shall be deemed to be a party to this Agreement.

(b) If the Voting Member or Voting Members having the option to purchase and the Successor in Interest to the Bankrupt Member cannot agree upon

(c) the purchase price within thirty (30) days after the first event of Bankruptcy, then the purchase price shall be based upon the Bankrupt Member's Proportionate Share multiplied by (x) the amount of cash and cash equivalents of the Company, plus (y) the fair market value of the assets of the Company other than cash and cash equivalents determined as provided in Section 13.5(d)(ii). Any valuation of the assets of the Company other than cash or cash equivalents shall be discounted by a ten percent (10%) if the event of Bankruptcy occurs on or prior to June 30, 2007, and shall be discounted by four percent (4%) if the event of Bankruptcy occurs on or prior to June 30, 2008.

(d) If the option to purchase is exercised, the expenses of all investment bankers shall be paid by the purchasing Member or Members. If the option to purchase is not exercised, the expenses of all investment bankers shall be paid by the Company.

(e) The purchase price, if the option is exercised, shall be payable as follows:

(i) Twenty percent (20%) of the purchase price shall be paid at closing in cash; and

(ii) The balance of the purchase price shall be paid within ninety (90) days after, the closing, plus interest on such amount at the Prime Rate plus two percent (2%) (but in no event at any interest rate higher than the maximum rate legally permitted). If not sooner paid, such purchase price balance and accrued interest thereon shall be payable in full upon sale or all or substantially all of the assets of the Company. The Successor in Interest shall have a continuing lien on the Interest being acquired by the purchaser to secure the payment of the balance of the purchase price and the interest due thereon, which lien may be foreclosed and enforced under applicable law. The purchaser will execute and deliver such instruments as may be necessary or appropriate to create such lien.

12. DISSOLUTION.

12.1. Events Causing Dissolution.

The Company shall be dissolved upon the first to occur of one of the following events:

(a) The election by the Board to dissolve the Company;

(b) An election to dissolve under Section 14.1(a)(i);

(c) The sale or other disposition of all or substantially all of the Company's assets;

(d) The delivery by IHCC of a Change in Control Notice or Dynex Special Withdrawal Notice as provided in Section 15.3;

(e) The delivery by a Member of a Regulatory Notice as provided in Section 15.4;

(f) An election to dissolve by a Non-Withdrawing Member under Section 13.5;

(g) The failure of the Company or the Non-Withdrawing Member to pay the purchase price for the redemption or purchase of the Withdrawing Member's Interest pursuant to Section 13.5(d), unless the Voting Members agree otherwise; and

(h) Unless the Voting Members otherwise agree, the sixtieth (60^{th}) day following the redemption of the CCAO Series 3 Trust Collateralized Bonds (which redemption date is expected to be, as of the date of this Agreement, on or about February 15, 2009).

12.2. Winding Up Company Affairs.

Upon the occurrence of an event specified in Section 15.1, the Manager shall wind up the affairs of the Company in accordance with the plan of liquidation adopted by the Board. If the Board cannot agree on a plan of liquidation within ninety (90) days after the occurrence of an event specified in Section 15.1, the Voting Members shall agree upon and the Company shall engage, within fifteen (15) days after the expiration of the ninety (90) day period, an investment banker to wind up the affairs of the Company. If the Voting Members are unable to agree upon an investment banker within such fifteen (15) day period, then one investment banker shall be selected by each Voting Member within five (5) days thereafter and such investment bankers shall jointly appoint within five (5) days of their selection a nationally recognized investment banker. However, in the event of an election to dissolve the Company under Section 14.1(a)(i), the non-Bankrupt Voting Member or Voting Members shall have the right to adopt the plan of liquidation and direct the Manager in winding up the affairs of the Company. After the payment of, or provision for, all debts of the Company, the proceeds of the sale of the Company assets and/or the Company assets shall be distributed to the Members in accordance with their Capital Accounts, subject to the provisions of Section 7.5. IHCC shall have the option, in any dissolution of the Company, to elect to receive a distribution in kind of the CCAO Series 2 Assets, and to the extent the value of this distribution in kind to IHCC of the CCAO Series 2 Assets exceeds the value of the distribution to which IHCC would otherwise be entitled under this Agreement, IHCC shall contribute to the Company for distribution to the other Members an amount of cash equal to the excess of the value of the CCAO Series 2 Assets over the distribution to which IHCC is otherwise entitled under this Agreement. If any assets are distributed in kind, they shall be distributed on the basis of the fair market value thereof as determined in accordance with Section 13.5(d)(ii), and shall be deemed to have been sold at fair market value for purposes of the allocations under Section 6.

12.3. Dynex Withdrawals.

(a) On or before June 30, 2008, IHCC may deliver a Change in Control Notice to the other Members. A Change in Control Notice shall specify that the Board of Directors of Dynex Capital, Inc. has determined in good faith, after consultation with its financial advisors and outside legal counsel, that it is consistent with its fiduciary duties to cause IHCC to withdraw from and cause the dissolution of the Company in order to engage in a Change in Control Transaction. The delivery of a Change in Control Notice shall be deemed to be an event causing the withdrawal of IHCC as a Member of the Company and the dissolution of the Company as provided in Section 15.1(d).

(b) IHCC may deliver a Dynex Special Withdrawal Notice to the other Members in either of the following circumstances:

(i) IHCC has determined, in good faith after consultation with its outside legal counsel, that the transactions contemplated by this Agreement or the status of IHCC will have the effect of causing the Company, IHCC, Dynex or any Affiliate of Dynex to be treated as a company required to register under the Investment Company Act of 1940.

(ii) IHCC has determined, in good faith after consultation with its outside legal counsel, that the transactions contemplated by this Agreement or the status of IHCC will have the effect of causing IHCC to not qualify as a qualified REIT subsidiary or to cause Dynex Capital to cease to satisfy the requirements under the Code and Regulations to continue to be treated as a “real estate investment trust.”

12.4. Regulatory Event.

Any Member may deliver a Regulatory Notice to the other Members. A Regulatory Notice shall specify that the Member has determined in good faith, after consultation with its outside legal counsel, that such Member and its Affiliates, taken as a whole, will experience a material and adverse impact with respect to regulatory, compliance, tax or accounting requirements if such Member continues to hold its Interest in the Company. The delivery of a Regulatory Notice shall be deemed to be an event causing the withdrawal of the Member delivering the notice as a Member of the Company and the dissolution of the Company as provided in Section 15.1(e).

Effect of Change in Control Notice, Dynex Special Withdrawal Notice or Regulatory Notice.

(a) If IHCC delivers a Change in Control Notice on or before June 30, 2007, IHCC shall reimburse the Company and DBAH for the reasonable costs of formation of the Company incurred by the Company or DBAH, respectively.

(b) If IHCC delivers a Change in Control Notice after June 30, 2007, or delivers a Dynex Special Withdrawal Notice, or if a Member delivers a Regulatory Notice, then the party giving the notice shall pay all costs associated with effecting the withdrawal contemplated by the notice, including the costs and expenses of the Company and the other Members.

13. ADMISSION OF ADDITIONAL MEMBERS.

Except as provided in Section 13.6 or 14.1(a)(iii), admission of a new Member shall require the consent of all Voting Members, which consent may be withheld in the sole discretion of any Voting Member. Upon admission, the business of the Company shall be continued without winding up.

14. AMENDMENTS.

Amendments to this Agreement shall require the written consent of all Voting Members. However, if a Voting Member does not execute, within sixty (60) days after receipt thereof, an amendment which is, in the opinion of counsel for the Company, necessary to satisfy requirements of the Code or Act with respect to partnerships or joint ventures or of any federal or state securities law or regulations and such amendment would not adversely affect the federal income tax treatment to be afforded a Member, adversely affect the liabilities of a Member, or change the method of allocation of Net Income or Net Loss, Gain or Loss from Sale, or the distribution (including, without limitation, the timing of distributions) of Net Proceeds from Financing or other funds available for distribution as provided in Section 7, then the Board shall make such amendment to this Agreement.

15. NOTICES.

15.1. Form of Notice. All notices, requests and other communications required or permitted to be given by this Agreement shall be in writing (including telexes, telecopies, facsimile transmissions, and similar writings) and shall be given to a Member or other Person at its address or telecopier or facsimile number set forth on Exhibit A or such other address or telecopier facsimile number as such Member or other Person may hereafter specify for that purpose by notice to the Members.

15.2. Effective Date of Notice. Each such notice, request or other communication shall be effective (1) if given by telecopier facsimile, when such telecommunication is transmitted and confirmation of receipt obtained; provided, however, that if any

15.3. notice, request or other communication so transmitted is received other than during the regular business hours of the recipient, it shall be deemed to have been given on the opening of business on the next business day of the recipient, (2) if given by mail, five days after such communication is deposited in the mails with first class postage prepaid, addressed as aforesaid or (3) if given by any other means, when delivered at the address specified on Exhibit A.

16. POWER OF ATTORNEY.

16.1. Appointment of Members as Attorney-in-Fact. Each Member irrevocably constitutes and appoints, with full power of substitution, the other Voting Member or Voting Members as its true and lawful attorney-in-fact with full power and authority in its name, place and stead for the following purposes: to execute, certify, acknowledge, deliver, swear to, file and record at the appropriate public offices, (i) any certificate identifying the Members, their addresses, the address of the Company and/or the term of the Company, (ii) any certificate identifying the name or names under which the Company conducts the Company Business, and (iii) any amendment of any certificate described in subsection (i) or (ii), which may be necessary to qualify, or to continue the qualification of, the Company to do business in any jurisdiction or which may otherwise be required in connection with the Company's transaction of business in any jurisdiction.

16.2. Irrevocable Appointment. The appointment by each Member of the other Voting Member or Voting Members as its attorney-in-fact is irrevocable and shall be deemed to be a power coupled with an interest and shall survive the Bankruptcy or dissolution of any Voting Member giving such power and the transfer or assignment of all or any part of the Interest of such Member; provided, however, that in the event of the transfer by a Member of all or any part of its Interest, this power of attorney of a transferor Member shall survive such transfer only until such time, if any, as the transferee shall have been admitted to the Company as a substituted Member and all required documents and instruments shall have been duly executed, filed and recorded to effect such substitution.

17. ARBITRATION.

17.1. Except as provided in Section 20.3, the Members acknowledge and agree that any dispute or controversy arising out of, relating to, or in connection with this Agreement, or the interpretation, validity, construction, performance, breach, or termination thereof, shall be submitted to binding arbitration in New York City before a panel of three arbitrators under the auspices of the American Arbitration Association, Commercial Arbitration Rules and Mediation Procedures (the "Rules"). The parties shall be deemed to have made these Rules, as amended and in effect as of the date of the submission of the dispute, a part of their agreement. Each party shall appoint a single arbitrator and the two party-selected arbitrators shall themselves appoint the third arbitrator, who shall serve as the panel chairman. The arbitrators may grant injunctions or other relief in

17.2. such dispute or controversy. The decision of the arbitrators shall be final, conclusive and binding on the parties to the arbitration. Judgment may be entered on the arbitrators' decision in any court having jurisdiction. In the arbitration, each party shall bear its own attorneys' fees, and the Company shall bear the other costs and expenses of the arbitration, unless and to the extent the arbitrators shall determine that under the circumstances such fees, costs and expenses should be paid by one of the parties.

17.3. The arbitrators shall apply Delaware law to the merits of any dispute or claim, without reference to rules of conflicts of law. Each Member hereby consents to the personal jurisdiction of the state and federal courts located in Virginia and New York for any action or proceeding arising from or relating to this Agreement or relating to any arbitration in which the parties are participants.

17.4. The parties may apply to any court of competent jurisdiction for a temporary restraining order, preliminary injunction, or other interim or conservatory relief, as necessary, without breach of this arbitration agreement and without abridgment of the powers of the arbitrators.

17.5. EACH MEMBER HEREBY CONFIRMS IT HAS READ AND UNDERSTANDS THIS SECTION 20.4, WHICH DISCUSSES ARBITRATION, AND UNDERSTANDS THAT BY SIGNING THIS AGREEMENT, IT AGREES, EXCEPT AS PROVIDED IN SECTION 20.3, TO SUBMIT ANY CLAIMS ARISING OUT OF, RELATING TO, OR IN CONNECTION WITH THIS AGREEMENT, OR THE INTERPRETATION, VALIDITY, CONSTRUCTION, PERFORMANCE, BREACH OR TERMINATION THEREOF TO BINDING ARBITRATION, UNLESS OTHERWISE REQUIRED BY LAW, AND THAT THIS ARBITRATION CLAUSE CONSTITUTES A WAIVER OF ITS RIGHT TO A JURY TRIAL.

18. GOVERNING LAW.

This Agreement and the rights and liabilities of the parties shall be determined in accordance with the laws of Delaware.

19. CAPTIONS.

Captions contained in this Agreement are inserted only as a matter of convenience and in no way define, limit, extend or describe the scope of this Agreement or the intent of any provision hereof.

20. CONSTRUCTION.

Whenever the context may require, any pronouns used herein shall include the corresponding masculine, feminine or neuter gender, and the use of nouns and pronouns in the singular shall include the plural and vice versa. This Agreement shall not be construed more strictly against one party than the others by virtue of the fact that it may have been prepared by counsel for one of the parties, it being recognized that all of the parties have contributed substantially and materially to the preparation of this Agreement

21. SEVERABILITY.

Every provision of this Agreement is intended to be severable. If any term or provision hereof is illegal or invalid for any reason whatsoever, such illegality or invalidity shall not affect the validity of the remainder of this Agreement.

22. EXECUTION AND COUNTERPARTS.

This Agreement and any amendment hereof may be executed in multiple counterparts, each of which shall be deemed an original and all of which shall constitute one agreement. In addition, this Agreement and any amendment hereof may be executed through the use of counterpart signature pages. The signature of any party on any counterpart agreement or signature page shall be deemed to be a signature to, and may be appended to, any other counterpart.

23. SUCCESSORS.

Subject to the limits on transferability contained herein, each and all of the covenants, terms, provisions and agreements herein contained shall be binding upon and inure to the benefit of the successors and the permitted assigns of the respective parties hereto.

24. ENTIRE AGREEMENT.

This Agreement, together with the exhibits hereto, constitutes the entire agreement among the Members and supersedes and cancels any prior agreements, representations, warranties or communications, whether oral or written, among the Members relating to the transactions contemplated hereby or the subject matter hereof.

[SIGNATURE LINES ON THE FOLLOWING PAGE]

IN WITNESS WHEREOF, the undersigned have each caused this Limited Liability Company Agreement of Copperhead Ventures, LLC to be executed as of the day and year first above written.

ISSUED HOLDINGS CAPITAL CORPORATION

By:
Name:
Title:

DARTMOUTH INVESTMENTS, LLP

By:
Name:
Title:

DBAH CAPITAL, LLC

By:
Name:
Title:

By:
Name:
Title:

Dynex Capital, Inc. hereby acknowledges its rights and obligations in its capacity as Manager of the Company.

DYNEX CAPITAL, INC.

By:_________________________________
Name:
Title:

EXHIBIT A

Percentage Interests in the Company

Member	Percentage Interest
Issued Holdings Capital Corporation c/o Dynex Capital, Inc. 4551 Cox Road Suite 300 Glen Allen, Virginia 23060 Fax: (804) 217-5860	49.875%
DBAH Capital, LLC 60 Wall Street New York, NY 10005 Fax: 212-797-5152	49.875%
Dartmouth Investments, LLP 16294 Via Venetia Delray Beach, FL 33484 Fax: 561-330-8006 With a copy to: John Knobelsdorf McNaughton Knobelsdorf 3730 Kirby Drive Houston, TX 77098 Fax: (713) 665-4369	0.25%

EXHIBIT B

Derivative Payments Agreement

EXHIBIT C

Form of Advisors Note

AGREEMENT

This DERIVATIVE PAYMENTS AGREEMENT (the "Agreement") is made as of September 16, 2006 among ISSUED HOLDINGS CAPITAL CORPORATION, a Virginia corporation (together with its successors and assigns, "IHCC") DYNEX CAPITAL, INC , a Virginia corporation (together with its successors and assigns, "Dynex"), and COPPERHEAD VENTURES, LLC, a Delaware limited liability company (together with its successors and assigns, "Copperhead").

In consideration of the mutual covenants and agreements set forth in this Agreement, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

Section 1. Definitions. Capitalized terms used herein and not otherwise defined herein have the meanings set forth on Exhibit A.

Section 2. Consideration. The parties to this Agreement acknowledge and agree that IHCC has been issued an interest in and admitted as a member of Copperhead, and that IHCC's agreements contained in this Agreement represent an integral portion of its capital contribution to Copperhead as described in Section 5.2(b) of the Limited Liability Company Agreement dated as of September 8, 2006 (the "LLC Agreement").

Section 3. Derivative Payments. IHCC shall pay to Copperhead, on each Payment Date, an amount equal to the sum of the Available Surplus and the payments due on the Series 2 Collateralized Bonds for such Payment Date distributed to IHCC as provided in Section 5. IHCC shall pay each such amount in immediately available funds by wire transfer to the following account (or to such other account as may be specified by Copperhead in writing):

Beneficiary:	Copperhead Ventures, LLC
Bank Name:	Wachovia Bank, NA
Bank Address:	Two James Center, 7th Floor 1021 East Cary Street, VA9620 Richmond, VA 23219
Account Name:	Copperhead Ventures, LLC
ABA Number:	051400549
Account Number:	2000034699744

Section 4. Dynex Guaranty. Dynex shall execute and deliver to Copperhead, on the date of this Agreement, a Guaranty substantially in the form attached as Exhibit B.

Section 5. Additional Covenants.

(a) IHCC will cause Commercial Capital to exercise in full any rights Commercial Capital may have (it being understood that Commercial Capital may have limited rights or no such rights) under the Series 2 Supplement to withdraw or otherwise receive the Available Surplus and the payments due on the Series 2 Collateralized Bonds and will cause Commercial Capital promptly to distribute all Available Surplus that it withdraws or otherwise receives, and such payments on the Series 2 Collateralized Bonds, to IHCC. IHCC will cause Commercial Capital not to take any action that could reasonably be expected to have a material adverse effect on the Available Surplus, provided, however that, notwithstanding anything in this Agreement to the contrary, IHCC shall be under no obligation to cause Commercial Capital to take any action or refrain from taking any action that Commercial Capital determines (based upon opinion of counsel) would be reasonably likely to constitute a breach of Commercial Capital's obligations under the Base Indenture or the Series 2 Supplement.

(b) IHCC will cause Commercial Capital to redeem the CCAO Series 2 Trust Collateralized Bonds on the earliest allowable date such bonds can be redeemed, and will cause Commercial Capital to pay to Copperhead any "Net Proceeds Available" from such redemption that might otherwise have not been paid to Copperhead pursuant to Section 3 of this Agreement. Net Proceeds Available for the purposes of this Section 5(b) equal the excess of the cash received by Commercial Capital from (i) the sale of the remaining loans collateralizing the CCAO Series 2 Trust Collateralized Bonds upon redemption, or (ii) the proceeds from the reissuance and resale of the CCAO Series 2 Trust Collateralized Bonds subsequent to their redemption, over the amount paid by Commercial Capital to redeem the CCAO Series 2 Trust Collateralized Bonds.

Section 6. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the Commonwealth of Virginia without giving effect to any choice of law or conflict of law provision or rule (whether of the Commonwealth of Virginia or any other jurisdiction) that would require the application of any other law.

Section 7. Counterparts. This Agreement may be executed in one or more counterpart copies, each of which will be deemed to be an original copy of this Agreement and all of which, when taken together, will be deemed to constitute one and the same agreement. The exchange of copies of this Agreement and of signature pages by facsimile transmission shall constitute effective execution and delivery of this Agreement as to the parties and may be used in lieu of the original Agreement for all purposes. Any signatures of the parties transmitted by facsimile shall be deemed to be their original signatures for all purposes.

Section 8. Assignment; Amendment. IHCC and Dynex may not assign any of their rights or delegate any of their obligations under this Agreement (whether by operation of law or otherwise) without the prior written consent of Copperhead. Copperhead may assign any of its rights or delegate any of its obligations under this Agreement with the prior written consent of IHCC (which consent shall not be unreasonably withheld). This Agreement may not be amended or otherwise modified except by a written agreement executed by the party to be charged with such amendment or other modification.

Section 9. Interpretation. The parties intend and agree that this Agreement shall constitute a "swap agreement" within the meaning of Section 101 of the United States Bankruptcy Code (the "Code") and that each of IHCC and Copperhead shall constitute a "swap participant" within the meaning of Section 101 of the Code.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

ISSUED HOLDINGS CAPITAL CORPORATION

By:
Name: Wayne Brockwell
Title: Senior Vice President

DYNEX CAPITAL, INC.

By:
Name: Stephen J. Benedetti
Title: Executive Vice President,
Chief Operating Officer

COPPERHEAD VENTURES, LLC
By Dynex Capital, Inc., Manager

By:
Name: Stephen J. Benedetti
Title: Executive Vice President,
Chief Operating Officer

Exhibit A
Derivative Payments Agreement Definitions

"Available Surplus" means, with respect to any Payment Date, all amounts, if any, able to be released to Commercial Capital on a Payment Date from the surplus account for the CCAO Series 2 Trust Collateralized Bonds pursuant to Sections 9(xiii) and (xiv) of the Series 2 Supplement with respect to that Payment Date, other than amounts related to the Series 2 Excluded Assets, as that term is defined in the LLC Agreement.

"Base Indenture" means the Indenture dated as of November 1, 1993, as amended, between Commercial Capital and the Trustee.

"CCAO Series 2 Trust Collateralized Bonds" means the bonds issued by Commercial Capital pursuant to the Base Indenture and the Series 2 Supplement.

"Commercial Capital" means Commercial Capital Access One, Inc., a Virginia corporation, together with its successors and assigns.

"Payment Date" means each date specified as a Payment Date for the Series 2 Collateralized Bonds, commencing with the first such date after the date of this Agreement (it being understood that, as of the date of this Agreement, the date specified as the Payment Date for the Series 2 Collateralized Bonds is the 15th day of each month (or, if such 15th day is not a Business Day, the next succeeding Business Day).

"Series 2 Collateralized Bonds" means Commercial Capital Access One Trust Collateralized Bonds, Series 2, Class E, Class F and Class G.

"Series 2 Supplement" means the Series 2 Supplement dated as of October 1, 1997 to the Base Indenture between Commercial Capital, as Issuer, and the Trustee.

"Trustee" means JPMorgan Chase Bank, National Association (formerly known as The Chase Manhattan Bank and successor by merger to Chase Bank of Texas, National Association (formerly known as Texas Commerce Bank National Association)), as Trustee.

Exhibit B
Form of Dynex Guaranty

GUARANTY

This GUARANTY (this "Guaranty" is made as of August 31, 2006 by DYNEX CAPITAL, INC., a Virginia corporation (together with its successors and assigns, "Dynex"), in favor of COPPERHEAD VENTURES, LLC, a Delaware limited liability company (together with its successors and assigns, "Copperhead").

Section 1. Guaranty. To induce Copperhead to enter into the Derivative Payments Agreement dated as of August 31, 2006 (the "Agreement") among Issued Holdings Capital Corporation, a Virginia corporation (together with its successors and assigns, "IHCC"), Dynex and Copperhead, Dynex irrevocably and unconditionally guarantees to Copperhead, and its successors and permitted assigns, the prompt payment by IHCC, on demand, of any amount due and payable to Copperhead under the Agreement (the ""Obligations"). Dynex hereby waives acceptance of this Guaranty, diligence, promptness, presentment, demand on IHCC for payment, protest of nonpayment and all notices of any kind. In addition, Dynex's obligations hereunder shall not be affected by the existence, validity, enforceability, perfection, or extent of any collateral therefor. Copperhead shall not be obligated to proceed against IHCC before claiming under this Guaranty or filing any claim relating to the Obligations in the event that IHCC becomes subject to a bankruptcy, reorganization or similar proceeding, and the failure of Copperhead so to file shall not affect Dynex's obligations hereunder. Dynex agrees that its obligations under this Guaranty constitute a guaranty of payment and not of collection.

Section 2. Consents, Waivers and Renewals. Dynex agrees that Copperhead may, at any time and from time to time, either before or after the maturity thereof, without notice to or further consent of Dynex, extend the time of payment of, exchange or surrender any collateral for, or renew any of the Obligations, and may also make any agreement with IHCC or with any other party to or person liable on any of the Obligations, or interested therein, for the extension, renewal, payment, compromise, discharge or release thereof, in whole or in part, or for any modification of the terms thereof or of any agreement between Copperhead and IHCC or any such other party or person, without in any way impairing or affecting this Guaranty. Dynex agrees that Copperhead may resort to Dynex for payment of any of the Obligations whether or not Copperhead shall have resorted to any collateral security or shall have proceeded against any other obligor principally or secondarily obligated with respect to any of the Obligations.

Section 3. Expenses. Dynex agrees to pay on demand all out-of-pocket expenses (including without limitation the reasonable fees and disbursements of Copperhead's counsel) incurred in the enforcement of the rights of Copperhead hereunder, provided, however, that Dynex shall not be liable for any expenses of Copperhead if no payment under this Guaranty is due.

Section 4. Subrogation. Dynex will not exercise any rights which it may acquire by way of subrogation until all of the Obligations shall have been paid in full. If any amount shall be paid to Dynex in violation of the preceding sentence, such amount shall be held for the benefit of Copperhead and shall forthwith be paid to Copperhead to be credited and applied to the Obligations, whether matured or unmatured. Subject to the foregoing, upon payment of all the Obligations, Dynex shall be subrogated to the rights of Copperhead against IHCC and Copperhead agrees to take at Dynex's expense such steps as Dynex may reasonably request to implement such subrogation.

Section 5. Cumulative Rights. No failure on the part of Copperhead to exercise, and no delay in exercising, any right, remedy or power hereunder shall operate as a waiver thereof, nor shall any single or partial exercise by Copperhead of any right, remedy or power hereunder preclude any other or future exercise of any right, remedy or power. Each and every right, remedy and power hereby granted to Copperhead or allowed it by law or other agreement shall be cumulative and not exclusive of any other, and may be exercised by Copperhead from time to time.

Section 6. Representations and Warranties. Dynex hereby represents and warrants to Copperhead that: (i) Dynex is a corporation duly organized, validly existing and in good standing under the laws of the Commonwealth of Virginia, (ii) Dynex has the absolute and unrestricted right, power and authority to execute and deliver this Guaranty and to perform its obligations under this Guaranty, and such action has been duly authorized by all necessary corporate action, (iii) this Guaranty constitutes the legal, valid and binding obligation of Dynex, enforceable against Dynex in accordance with its terms, except that such enforcement may be subject to bankruptcy, receivership, insolvency, moratorium, reorganization, fraudulent transfer or similar laws affecting the enforcement of the rights of creditors generally and to legal and equitable limitations on the enforceability of specific remedies; and (iv) neither the execution and delivery of this Guaranty nor the performance by Dynex of its obligations under this Guaranty will, directly or indirectly (with or without notice or lapse of time), conflict with or violate any provision of the articles of incorporation or bylaws of Dynex or violate any applicable law, rule or regulation.

Section 7. Continuing Guaranty. This Guaranty shall remain in full force and effect and be binding upon Dynex and its successors and permitted assigns, and inure to the benefit of Copperhead and its successors and permitted assigns, until all of the Obligations shall have been paid in full. In the event that any payment by IHCC in respect of any Obligation is rescinded or must otherwise be returned for any reason whatsoever, Dynex shall remain liable hereunder in respect of such Obligation as if such payment had not been made.

Section 8. Notices. All notices in connection with this Guaranty shall be deemed effective, if in writing and delivered in person or by courier, on the date delivered to the following address (or such other address which Dynex shall notify Copperhead of in writing):

Dynex Capital, Inc.
4551 Cox Road, Suite 300
Glen Allen, Virginia 23060
Attention: Executive Vice President, Chief Operating Officer

Section 9. Governing Law. This Guaranty shall be governed by and construed in accordance with the laws of the Commonwealth of Virginia without giving effect to any choice of law or conflict of law provision or rule (whether of the Commonwealth of Virginia or any other jurisdiction) that would require the application of any other law.

IN WITNESS WHEREOF, Dynex has executed this Guaranty as of the date first written above.

DYNEX CAPITAL, INC.

By:

Name: Stephen J. Benedetti

Title: Executive Vice President,
Chief Operating Officer

Exhibit C to the LLC Agreement

PROMISSORY NOTE

$184,000.00 September 16, 2006

FOR VALUE RECEIVED, the undersigned, **DARTMOUTH INVESTMENTS, LLP,** a Texas limited liability partnership, (the "Maker"), promises to pay, without offset, deduction or abatement, except as provided herein, to the order of **COPPERHEAD VENTURES, LLC,** a Delaware limited liability company ("Payee"; Payee and any subsequent holder(s) hereof are hereinafter referred to collectively as "Holder"), at the office of Payee at 4551 Cox Road, Suite 300, Glen Allen, Virginia, 23060, or at such other place as Holder may designate to Maker in writing from time to time, the principal sum of One Hundred Eighty-Four Thousand Dollars ($184,000), together with interest on the outstanding principal balance hereof from the date hereof at the rate described below.

Interest shall accrue on the outstanding principal balance of this Note at the "Prime Rate" (as defined below and computed on the basis of a 360-day year). "Prime Rate" shall mean the annual prime rate (or base rate) reported in the "Money Rates" column or section of The Wall Street Journal as being the base rate on corporate loans at larger U.S. Money Center commercial banks on the first date on which The Wall Street Journal is published in each month. In the event The Wall Street Journal ceases publication of the Prime Rate, then the "Prime Rate" shall mean the "prime rate" or "base rate" announced by Bank of America, N.A. or the successor to substantially all of its assets and business (whether or not such rate has actually been charged by that bank). In the event that bank discontinues the practice of announcing that rate, Prime Rate shall mean the highest rate charged by that bank on short-term, unsecured loans to its most credit-worthy large corporate borrowers.

Principal payments and accrued interest under this Note will be paid to Holder in accordance with Sections 7.5 and/or 13.8(b) of the Limited Liability Company Agreement of Copperhead Ventures, LLC of even date herewith (the "LLC Agreement"), from distributions or payments that would otherwise be made to Maker under Sections 7.5 or 13.8 of the LCC Agreement, as applicable, until the earlier of such time this Note is paid in full or March 15, 2009. Provided no Event of Default (as defined below) has occurred and is continuing, effective as of March 15, 2009, any remaining principal balance of and accrued interest under this Note shall be forgiven by Holder as provided in Section 5.2(c) of the LLC Agreement.

All payments received or otherwise deemed to be made by virtue of the LLC Agreement shall be applied first to any Late Charge (as defined below) due hereunder, then to any accrued but unpaid interest, then the balance of any payment shall be applied to the outstanding principal balance of this Note. If an Event of Default occurs, monies may be applied to this Note in any manner or order deemed appropriate by Holder.

The indebtedness evidenced hereby may be prepaid in whole or in part, at any time and from time to time, without premium or penalty. Any such prepayments shall be credited first to any Late Charges, then to accrued and unpaid interest and then to the outstanding principal balance hereof.

TIME IS OF THE ESSENCE for this Note. It is hereby expressly agreed that in the event that any default shall occur in the performance of any of Maker's obligations hereunder (an "Event of Default"), then, and in such event, the entire outstanding principal balance of the indebtedness evidenced hereby, together with any other sums advanced hereunder, and/or under any other instrument or document now or hereafter evidencing, securing or in any way relating to the indebtedness evidenced hereby, together with all unpaid interest accrued thereon, shall, at the option of Holder and without notice to Maker, at once become due and payable and may be collected forthwith, regardless of the stipulated date of maturity.

Maker shall pay without demand a late charge equal to ten percent (10%) of any principal and/or interest which is not paid within ten (10) days after its due date ("Late Charge"). In the event this Note is placed in the hands of an attorney for collection, or if Holder incurs any costs incident to the collection of the indebtedness evidenced hereby, Maker and any endorsers hereof agree to pay to Holder an amount equal to all such costs, including without limitation all reasonable attorneys' fees (based on such attorneys' normal hourly rates and actual time expended) and all court costs.

Presentment for payment, demand, protest and notice of demand, protest and nonpayment are hereby waived by Maker and all other parties hereto. No failure to accelerate the indebtedness evidenced hereby by reason of an Event of Default hereunder, acceptance of a past-due installment or other indulgences granted from time to time, shall be construed as a novation of this Note or as a waiver of such right of acceleration or of the right of Holder thereafter to insist upon strict compliance with the terms of this Note or to prevent the exercise of such right of acceleration or any other right granted hereunder or by applicable law. No extension of the time for payment of the indebtedness evidenced hereby or any installment due hereunder, made by agreement with any person now or hereafter liable for payment of the indebtedness evidenced hereby, shall operate to release, discharge, modify, change or affect the original liability of Maker hereunder or that of any other person now or hereafter liable for payment of the indebtedness evidenced hereby, either in whole or in part, unless Holder agrees otherwise in writing. This Note may not be changed orally, but only by an agreement in writing signed by the party against whom enforcement of any waiver, change, modification or discharge is sought.

This Note is intended as a contract under and shall be construed and enforceable in accordance with the laws of the State of Delaware.

If Holder is unable to obtain prompt legal service on Maker at the address shown for Maker below, Maker hereby appoints the Secretary of State of the State of Delaware as Maker's agent for the acceptance of substituted service of process upon Maker.

TO THE FULLEST EXTENT POSSIBLE, MAKER WAIVES IN FULL THE RIGHT TO A TRIAL BY JURY IN REGARD TO ANY DISPUTES, CLAIMS, CAUSES OF ACTION, OBLIGATIONS, DAMAGES, COMPLAINTS, LITIGATION OR ANY MATTER WHATSOEVER AND OF ANY TYPE OR NATURE, WHETHER IN CONTRACT, TORT OR OTHERWISE, WHICH MAKER MAY HAVE NOW OR IN THE FUTURE RELATING TO THIS NOTE. BY EXECUTION OF THISNOTE, MAKER REPRESENTS AND WARRANTS THAT MAKER IS REPRESENTED BY COMPETENT COUNSEL WHO HAS FULLY AND COMPLETELY ADVISED MAKER OF THE MEANING AND RAMIFICATIONS OF THE RIGHT OF MAKER TO A TRIAL BY JURY OR HAD THE FULL AND COMPLETE OPPORTUNITY TO CONSULT SUCH COUNSEL AND CHOSE NOT TO DO SO, AND, THEREFORE, MAKER FREELY AND VOLUNTARILY WAIVES SUCH RIGHT TO TRIAL BY JURY.

<u>Maker hereby agrees that any dispute with respect to this Note shall be resolved in the manner provided in Section 20 of the LLC Agreement.</u>

As used herein, the terms "Maker" and "Holder" shall be deemed to include their respective successors, legal representatives and assigns, whether by voluntary action of the parties or by operation of law.

<u>MAKER</u>:

Maker's Address for Notices: DARTMOUTH INVESTMENTS, LLP

By:

Name:

Title:

16294 Via Venetia
Delray Beach, FL 33484
Fax: (561) 330-8006

With a copy to:

John Knobelsdorf
McNaughton Knobelsdorf
3730 Kirby Drive
Houston, TX 77098
Fax: (713) 665-4369

Exhibit 31.1

CERTIFICATION
PURSUANT TO 17 CFR 240.13a-14
PROMULGATED UNDER
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Stephen J. Benedetti, certify that:

1. I have reviewed the Quarterly Report on Form 10-Q of Dynex Capital, Inc. for the quarter ended September 30, 2006;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this report is being prepared;

   (b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2006

/s/ Stephen J. Benedetti
Stephen J. Benedetti
Principal Executive Officer and
Principal Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Dynex Capital, Inc. (the "Company") for the quarter ended September 30, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Stephen J. Benedetti, the Principal Executive Officer and the Chief Financial Officer of the Company, certify, pursuant to and for purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 14, 2006

/s/ Stephen J. Benedetti
Stephen J. Benedetti
Principal Executive Officer and
Principal Financial Officer