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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

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

For the quarter ended June 30, 1999

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

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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.)

10900 Nuckols Road, 3rd Floor, Glen Allen, Virginia  
(Address of principal executive offices)

23060  
(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 ninety days.

☒ Yes ☐ No

On July 31, 1999, the registrant had 46,033,978 shares of common stock of  
\$.01 value outstanding, which is the registrant's only class of common stock.  
The Company effected a one-for-four reverse common stock split on August 2,  
1999.

DYNEX CAPITAL, INC.  
FORM 10-Q

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## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

DYNEX CAPITAL, INC.

CONSOLIDATED BALANCE SHEETS

(amounts in thousands except share data)

<TABLE>

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ASSETS	June 30, 1999	December 31, 1998
<S>	<C>	<C>
Investments:		
Collateral for collateralized bonds	\$ 3,811,836	\$ 4,293,528
Securities	209,889	243,984
Other investments	41,972	30,371
Loans held for securitization	405,479	388,782
	4,469,176	4,956,665
Investment in and net advances to Dynex Holding, Inc.	183,083	169,384
Cash	34,908	30,103
Accrued interest receivable	2,835	4,162
Other assets	19,461	18,488
	4,709,463	5,178,802
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Non-recourse debt	\$ 3,373,186	\$ 3,665,316
Recourse debt:		
Secured by collateralized bonds retained	150,951	298,695
Secured by investments	607,195	588,735
Unsecured	121,870	145,303
	4,253,202	4,698,049
Accrued interest payable	6,154	8,403
Accrued expenses and other liabilities	8,958	16,318
Dividends payable	3,228	3,228
	4,271,542	4,725,998
SHAREHOLDERS' EQUITY		
Preferred stock, par value \$.01 per share, 50,000,000 shares authorized:		
9.75% Cumulative Convertible Series A, 1,309,061 and 1,309,061 issued and outstanding, respectively	29,900	29,900
9.55% Cumulative Convertible Series B,		

1,912,434 and 1,912,434 issued and outstanding, respectively	44,767	44,767
9.73% Cumulative Convertible Series C,		
1,840,000 and 1,840,000 issued and outstanding, respectively	52,740	52,740
Common stock, par value \$.01 per share,		
100,000,000 shares authorized,		
11,508,237 (1) and 46,027,426 issued and outstanding, respectively	115	460
Additional paid-in capital	352,684	352,382
Accumulated other comprehensive loss	(17,316)	(3,097)
Accumulated deficit	(24,969)	(24,348)
	-----	-----
	437,921	452,804
	-----	-----
	\$ 4,709,463	\$ 5,178,802
	=====	=====

<FN>

(1) Reflects the one-for-four reverse common stock split which became effective on August 2, 1999.

See notes to unaudited consolidated financial statements.

</FN>

</TABLE>

DYNEX CAPITAL, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(amounts in thousands except share data)

<TABLE>

<CAPTION>

	Three Months Ended June 30,		Six Months Ended June 30,	
	-----		-----	
	1999	1998	1999	
	-----	-----	-----	-----
1998				
<S>	<C>	<C>	<C>	
<C>				
Interest income:				
Collateral for collateralized bonds	\$ 71,300	\$ 74,130	\$ 142,538	\$
145,710				
Securities	3,006	15,574	7,596	
30,603				
Other investments	786	1,160	1,370	
2,477				
Loans held for securitization	5,316	16,101	12,689	
22,855				
Net advances to Dynex Holding, Inc.	3,556	2,505	6,889	
4,857				
	-----	-----	-----	-----
	83,964	109,470	171,082	
	-----	-----	-----	-----
206,502				
Interest and related expense:				
Non-recourse debt	51,956	57,498	107,163	
115,413				
Recourse debt	12,850	32,533	29,025	
52,598				
Other	791	527	1,521	
953				
	-----	-----	-----	-----
	65,597	90,558	137,709	
	-----	-----	-----	-----
168,964				
Net interest margin before provision for losses	18,367	18,912	33,373	
37,538				
Provision for losses	(3,773)	(1,726)	(7,566)	
(3,206)				
	-----	-----	-----	-----
Net interest margin	14,594	17,186	25,807	
34,332				

Equity in net earnings (loss) of Dynex Holding, Inc. 2,007	290	1,616	(79)	
Net (loss) gain on sale of investments and trading activities 7,728	(5,541)	3,264	(6,467)	
Other income 1,145	961	726	2,320	
-----	-----	-----	-----	-----
Net revenue 45,212	10,304	22,792	21,581	
General and administrative expenses (4,121)	(1,961)	(1,746)	(3,969)	
Net administrative fees and expenses to Dynex Holding, Inc. (11,060)	(5,366)	(5,447)	(11,290)	
-----	-----	-----	-----	-----
Income before extraordinary item 30,031	2,977	15,599	6,322	
Extraordinary item - extinguishment of debt -	597	-	(489)	
-----	-----	-----	-----	-----
Net income after extraordinary item 30,031	3,574	15,599	5,833	
Dividends on preferred stock (6,563)	(3,226)	(3,276)	(6,454)	
=====	=====	=====	=====	
Net income (loss) available to common shareholders 23,468	\$ 348	\$ 12,323	\$ (621)	\$
=====	=====	=====	=====	
Per common share before extraordinary item (1): Basic 2.06	\$ (0.02)	\$ 1.08	\$ (0.01)	\$
=====	=====	=====	=====	
Diluted 2.06	\$ (0.02)	\$ 1.08	\$ (0.01)	\$
=====	=====	=====	=====	
Per common share after extraordinary item (1): Basic 2.06	\$ 0.03	\$ 1.08	\$ (0.05)	\$
=====	=====	=====	=====	
Diluted 2.06	\$ 0.03	\$ 1.08	\$ (0.05)	\$
=====	=====	=====	=====	

<FN>

(1) Reflects the one-for-four reverse common stock split which became effective on August 2, 1999.

See notes to unaudited consolidated financial statements.

</FN>

</TABLE>

DYNEX CAPITAL, INC.  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
For the six months ended June 30, 1999  
(amounts in thousands)

<TABLE>

<CAPTION>

Total	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	
-----	-----	-----	-----	-----	-----	
<S>	<C>	<C>	<C>	<C>	<C>	
<C>						
Balance at December 31, 1998	\$ 127,407	\$ 460	\$ 352,382	\$ (3,097)	\$ (24,348)	\$

452,804

Comprehensive income:

Net income - six months ended June 30, 1999	-	-	-	-	5,833
5,833					
Change in net unrealized loss on investments classified as available-for-sale during the period (14,219)	-	-	-	(14,219)	-
-----					
Total comprehensive income (8,386)	-	-	-	(14,219)	5,833
Issuance of common stock 26	-	-	26	-	-
One-for-four reverse common stock split	-	(345)	345	-	-
-					
Forfeitures of restricted stock awards (69)	-	-	(69)	-	-
Dividends on preferred stock (6,454)	-	-	-	-	(6,454)
-----					
Balance at June 30, 1999 437,921	\$ 127,407	\$ 115	\$ 352,684	\$ (17,316)	\$ (24,969)
					\$

<FN>

See notes to unaudited consolidated financial statements.

</FN>

</TABLE>

DYNEX CAPITAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

<TABLE>

<CAPTION>

(amounts in thousands)	Six Months Ended	
	June 30,	
	1999	1998
<S>	<C>	<C>
Operating activities:		
Net (loss) income	\$ (621)	\$ 23,468
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Provision for losses	7,566	3,206
Net loss (gain) on sale of investments and trading activities	6,467	(7,728)
Equity in net loss (earnings) of Dynex Holding, Inc.	79	(2,007)
Extraordinary item - extinguishment of debt	489	-
Amortization and depreciation	17,290	24,510
Net increase in accrued interest, other assets and other liabilities	(15,324)	(8,169)
Net cash provided by operating activities	15,946	33,280
Investing activities:		
Collateral for collateralized bonds:		
Fundings of investments subsequently securitized	(280,907)	(1,378,951)
Principal payments on collateral	723,895	1,033,445
Decrease (increase) in accrued interest receivable	5,760	(2,293)
Net increase in funds held by trustee	(894)	(4,206)
Net increase in loans held for securitization	(18,031)	(249,978)
Purchase of other investments	(17,740)	(7,210)
Payments received on other investments	6,493	9,144
Purchase of securities	(23,513)	(283,177)
Payments received on securities	47,572	86,552
Proceeds from sales of securities	15,905	78,569
Investment in and net advances to Dynex Holding, Inc.	(13,778)	(27,942)
Proceeds from sale of single family operations	-	9,500
Capital expenditures	(34)	(216)
Net cash provided by (used for) investing activities	444,728	(736,763)

Financing activities:

Collateralized bonds:

Proceeds from issuance of bonds	418,162	1,515,241
Principal payments on bonds	(715,682)	(1,013,553)
Increase (decrease) in accrued interest payable	1,392	(361)
Repayment of senior notes	(5,605)	-
(Repayments of) proceeds from recourse debt borrowings, net	(147,708)	242,193
Net proceeds from issuance of common stock	26	4,040
Retirement of common stock	-	(609)
Dividends paid	(6,454)	(36,459)
	-----	-----
Net cash (used for) provided by financing activities	(455,869)	710,492
	-----	-----
Net increase in cash	4,805	7,009
Cash at beginning of period	30,103	18,502
	=====	=====
Cash at end of period	\$ 34,908	\$ 25,511
	=====	=====
Cash paid for interest	\$ 134,479	\$ 161,944
	=====	=====
Supplemental disclosure of non-cash activities:		
Collateral for collateralized bonds subsequently securitized	\$ 1,161,475	\$ -
	=====	=====
Securities owned subsequently securitized	\$ -	\$ 257,959
	=====	=====
Other investments owned subsequently securitized	\$ -	\$ 37,221
	=====	=====

<FN>  
See notes to unaudited consolidated financial statements.  
</FN>  
</TABLE>

DYNEX CAPITAL, INC.  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
June 30, 1999  
(amounts in thousands except share data)

#### NOTE 1--BASIS OF PRESENTATION

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

In the opinion of management, all material adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the consolidated financial statements have been included. The Consolidated Balance Sheets at June 30, 1999 and December 31, 1998, the Consolidated Statements of Operations for the three and six months ended June 30, 1999 and 1998, the Consolidated Statement of Shareholders' Equity for the six months ended June 30, 1999, the Consolidated Statements of Cash Flows for the six months ended June 30, 1999 and 1998 and related notes to consolidated financial statements are unaudited. Operating results for the six months ended June 30, 1999 are not necessarily indicative of the results that may be expected for the year ending December 31, 1999. For further information, refer to the audited consolidated financial statements and footnotes included in the Company's Form 10-K for the year ended December 31, 1998.

Certain reclassifications have been made to the financial statements for 1998 to conform to presentation for 1999.

## NOTE 2--EARNINGS PER SHARE

Earnings per share ("EPS") as shown on the Consolidated Statements of Operations for the three and six months ended June 30, 1999 and 1998 is presented on both a basic and diluted EPS basis. Any reference herein to EPS or the number of shares of common stock, except the number of shares authorized at December 31, 1998, are after the effect of the one-for-four reverse split of the Company's common stock discussed in Note 12. Diluted EPS assumes the conversion of the convertible preferred stock into common stock, using the if-converted method, and stock appreciation rights ("SARs"), using the treasury stock method but only if these items are dilutive. The preferred stock is convertible into one share of common stock for two shares of preferred stock.

The following table reconciles the numerator and denominator for both the basic and diluted EPS for the three and six months ended June 30, 1999 and 1998.

	Three Months Ended June 30,				Six Months Ended June 30,			
	1999		1998		1999			
1998								
	Weighted-Average		Weighted-Average		Weighted-Average			
	Number of		Number of		Number of			
	Income	Shares	Income	Shares	Income	Shares	Income	
Shares								
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	
<C>								
Income before extraordinary item	\$ 2,977		\$15,599		\$ 6,322		\$30,031	
Extraordinary item - gain (loss) on extinguishment of debt	597		-		(489)		-	
Net income after extraordinary item	3,574		15,599		5,833		30,031	
Less: Dividends paid on preferred stock	(3,226)		(3,276)		(6,454)		(6,563)	
Basic and diluted 11,387,060	\$ 348	11,508,067	\$ 12,323	11,418,487	\$ (621)	11,507,751	\$23,468	
Earnings per share before extraordinary item (1):								
Basic EPS		\$ (0.02)		\$ 1.08		\$ (0.01)		\$
2.06								
Diluted EPS		\$ (0.02)		\$ 1.08		\$ (0.01)		\$
2.06								
Earnings per share after extraordinary item (1):								
Basic EPS		\$ 0.03		\$ 1.08		\$ (0.05)		\$
2.06								
Diluted EPS		\$ 0.03		\$ 1.08		\$ (0.05)		\$
2.06								
Reconciliation of anti-dilutive shares:								
Dividends and additional shares of preferred stock:								
Series A	\$ 766	654,531	\$ 785	657,605	\$ 1,531	654,531	\$ 1,579	
667,198								
Series B	1,118	956,217	1,148	956,742	2,237	956,217	2,298	
962,398								
Series C	1,342	920,000	1,343	920,000	2,686	920,000	2,686	
920,000								

Expense and incremental shares of stock appreciation rights	-	22,350	100	40,572	2	22,350	600
40,572	-----	-----	-----	-----	-----	-----	-----
-----							
2,590,168	\$ 3,226	2,553,098	\$ 3,376	2,574,919	\$ 6,456	2,553,098	\$ 7,163
=====	=====	=====	=====	=====	=====	=====	=====
<FN>							

(1) Reflects the one-for-four reverse common stock split which became effective on August 2, 1999.

&lt;/TABLE&gt;

The following table summarizes Dynex REIT's amortized cost basis and fair value of investments, as of June 30, 1999 and December 31, 1998, classified as available-for-sale and the related average effective interest rates:

<CAPTION>

&lt;/TABLE&gt;

Collateral for collateralized bonds. Collateral for collateralized bonds consists primarily of securities backed by adjustable-rate and fixed-rate mortgage loans secured by first liens on single family housing, fixed-rate loans on multifamily and commercial properties and manufactured housing installment loans secured by either a UCC filing or a motor vehicle title. All collateral for collateralized bonds is pledged to secure repayment of the related collateralized bonds. All principal and interest (less servicing-related fees) on the collateral is remitted to a trustee and is available for payment on the collateralized bonds. Dynex REIT's exposure to loss on collateral for collateralized bonds is generally limited to the principal amount of collateral pledged in excess of the related collateralized bonds issued, as the collateralized bonds issued by the limited-purpose finance subsidiaries are non-recourse to Dynex REIT.



of Liabilities" ("FAS No. 125") as Dynex REIT retained call rights which were substantially in excess of a clean-up call as defined by this accounting standard.

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

Sale of Investments. Securities with an aggregate principal balance of \$15,972 were sold during the six months ended June 30, 1999 for an aggregate gain of \$210. The specific identification method is used to calculate the basis of securities sold. Gain on sale of investments and trading activities at June 30, 1999 also includes (i) realized losses of \$4,488 related to the sale or writedown of \$49,739 of commercial loans during the six months ended June 30, 1999; (ii) realized losses of \$2,680 primarily related to write-off of hedging positions on \$64,433 of commercial loan commitments during the six months ended June 30, 1999, (iii) realized gains of \$1,512 on various derivative trading positions entered into during the six months ended June 30, 1999 and (iv) writedowns for permanent impairment of certain residual interests of \$1,443. At June 30, 1999, the Company had option positions outstanding with a notional value of \$500 million and a mark-to-market loss of \$99.

The Company uses estimates in establishing fair value for its financial instruments. Estimates of fair value for financial instruments may be based on market prices provided by certain dealers. Estimates of fair value for certain other financial instruments are determined by calculating the present value of the projected cash flows of the instruments using appropriate discount rates, prepayment rates and credit loss assumptions. The discount rates used are based on management's estimates of market rates, and the cash flows are projected utilizing the current interest rate environment and forecasted prepayment rates. Estimates of fair value for other financial instruments are based primarily on management's judgment. Since the fair value of the Company's financial instruments is based on estimates, actual gains and losses recognized may differ from those estimates recorded in the consolidated financial statements.

#### NOTE 4 --RECOURSE DEBT

Dynex REIT utilizes repurchase agreements, notes payable and warehouse credit facilities (together, "recourse debt") to finance certain of its investments. The following table summarizes Dynex REIT's recourse debt outstanding at June 30, 1999 and December 31, 1998:

<TABLE>  
<CAPTION>

	June 30, 1999	December 30, 1998
<S>	<C>	<C>
Recourse debt secured by:		
Collateralized bonds	\$ 150,951	\$ 298,695
Securities	153,589	192,706
Other investments	178,551	142,883
Loans held for securitization	272,715	250,589
Other assets	2,340	2,557
	758,146	887,430
Unsecured debt:		
7.875% senior notes	96,180	98,718
Series B 10.03% senior notes	23,053	26,116
Series A 9.56% senior notes	2,637	2,969
Bank credit facility	-	17,500
	\$ 880,016	\$ 1,032,733

</TABLE>

Of the \$758,146 of secured recourse debt outstanding at June 30, 1999, \$216,201 was outstanding under repurchase agreements, \$539,605 represented amounts outstanding under committed credit facilities and \$2,340 represented amounts outstanding under a capital lease. During the quarter ended June 30, 1999, Dynex REIT extinguished \$2,750 of its 7.875% Senior Notes resulting in a

\$597 extraordinary gain.

#### NOTE 5 -- ADOPTION OF FINANCIAL ACCOUNTING STANDARDS

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

#### NOTE 6--DERIVATIVE FINANCIAL INSTRUMENTS

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

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

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

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

Dynex REIT may also enter into forward delivery contracts and interest rate futures and options contracts for hedging interest rate risk associated with commitments made to fund loans. Gains and losses on such contracts are either (i) deferred as an adjustment to the carrying value of the related loans until the loan has been funded and securitized in a collateralized bond structure, after which the gains or losses will be amortized into income over the remaining life of the loan using a method that approximates the effective yield method, or (ii) deferred until such time as the related loans are funded and sold.

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

#### NOTE 7 -- EMPLOYEE BENEFITS

During the six months ended June 30, 1999, 149,742 Stock Appreciation

Rights ("SARs") under the Employee Incentive Plan were awarded. The total SARs either forfeited or exercised during the six months ended June 30, 1999 were 17,705. The total SARs remaining to be exercised were 351,732 at June 30, 1999. The Company expensed \$2 related to the Employee and Board Incentive Plans during the six months ended June 30, 1999.

#### NOTE 8 -- COMMITMENTS

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

Dynex REIT facilitates the issuance of tax-exempt multifamily housing bonds, the proceeds of which are used to fund mortgage loans on multifamily properties. Dynex REIT is required to pay principal and interest to the bondholders in the event there is a payment shortfall from the construction proceeds. In addition, Dynex REIT is required to purchase the bonds if such bonds are not able to be remarketed by the remarketing agent. Therefore, Dynex REIT enters into standby letter of credit agreements to cover such commitments. At June 30, 1999, Dynex REIT provided letters of credit to support its obligations in amounts equal to \$121,016.

#### NOTE 9 -- RELATED PARTY TRANSACTIONS

Dynex REIT has a credit arrangement with DHI whereby DHI and any of DHI's subsidiaries can borrow funds from Dynex REIT to finance its production operations. Under this arrangement, Dynex REIT can also borrow funds from DHI. The terms of the agreement allow DHI and its subsidiaries to borrow up to \$50 million from Dynex REIT at a rate of Prime plus 1.0%. Dynex REIT can borrow up to \$50 million from DHI at a rate of one-month LIBOR plus 1.0%. This agreement has a one-year maturity which is extended automatically unless notice is received from one of the parties to the agreement within 30 days of the anticipated termination of the agreement. As of June 30, 1999 and December 31, 1998, net borrowings due to DHI under this agreement totaled \$33,329 and \$8,583, respectively. Net interest expense under this agreement was \$69 and \$701 for the six months ended June 30, 1999 and 1998, respectively.

Dynex REIT also has a loan origination agreement with Dynex Financial, Inc. ("DFI"), an operating subsidiary of DHI, whereby Dynex REIT pays DFI on a fee plus cost basis for the origination of manufactured housing loans on behalf of Dynex REIT. During the six months ended June 30, 1999 and 1998, Dynex REIT paid DFI \$8,703 and \$7,306, respectively under such agreement.

Dynex REIT has a loan origination agreement with Dynex Commercial, Inc. ("DCI"), an operating subsidiary of DHI, whereby Dynex REIT pays DCI a fee per commercial loan originated on behalf of Dynex REIT. Dynex REIT paid DCI \$1,471 and \$2,707, respectively under this agreement for the six months ended June 30, 1999 and 1998.

Dynex REIT has various note agreements with Dynex Residential, Inc. ("DRI"), an operating subsidiary of DHI, and DRI's subsidiaries whereby DRI and its subsidiaries can borrow up to \$287,000 from Dynex REIT on a secured basis to finance the acquisition of model homes from single family home builders. The interest rate on the notes is adjustable and is based on 30-day LIBOR plus 2.875%. The outstanding balance of the notes as of June 30, 1999 and December 31, 1998 was \$199,098 and \$159,377, respectively. Interest income recorded by Dynex REIT on the notes for the six months ended June 30, 1999 and 1998 was \$6,958 and \$5,558, respectively.

Dynex REIT has entered into subservicing agreements with DCI and DFI to service commercial, single family, consumer and manufactured housing loans. For servicing the commercial loans, DCI receives an annual servicing fee of 0.02% of the aggregate unpaid principal balance of the loans. For servicing the single family mortgage, consumer and manufactured housing loans, DFI receives annual fees ranging from sixty dollars (\$60) to one hundred forty-four dollars (\$144) per loan and certain incentive fees. Servicing fees paid by Dynex REIT under such agreements were \$1,257 and \$355 during the six months ended June 30, 1999 and 1998, respectively.

Dynex REIT through its ownership of preferred stock, has a 99% economic ownership interest in DHI.

#### NOTE 10 -- INVESTMENT IN AND NET ADVANCES TO DYNEX HOLDING, INC.

In December 1998, Dynex REIT changed its method of accounting for its investment in DHI from the full consolidation method to a method that approximates the equity method. The accounting change had no impact on net income. For consistency purposes, Dynex REIT has revised the June 1998 financial statements to give retroactive effect to the change in accounting method.

Investment in and net advances to DHI accounted for under a method similar

to the equity method amounted to \$183,083 and \$169,384 at June 30, 1999 and December 31, 1998, respectively. The results of operations and financial position of DHI are summarized below:

<TABLE>  
<CAPTION>

Condensed Income Statement Information	Three Months ended June 30,		Six Months ended June 30,	
	1999	1998	1999	1998
<S>	<C>	<C>	<C>	<C>
Total revenues	\$ 10,703	\$ 10,338	\$ 21,752	\$ 20,009
Total expenses	10,410	8,706	21,831	17,982
Net (loss) income	293	1,632	(79)	2,027

</TABLE>

<TABLE>  
<CAPTION>

Condensed Balance Sheet Information	June 30,	December 31,
	1999	1998
<S>	<C>	<C>
Total assets	\$ 247,351	\$ 203,541
Total liabilities	229,563	184,267
Total equity	17,788	19,274

</TABLE>

#### NOTE 11--OTHER MATTERS

During the six months ended June 30, 1999, the Company issued 1,381 shares of its common stock pursuant to its dividend reinvestment program for net proceeds of \$26. The Company did not repurchase any of its capital stock during the second quarter. The Company has remaining authorization to purchase up to 915,000 shares of its capital stock.

#### NOTE 12--SUBSEQUENT EVENTS

At the special meeting of shareholders, held on July 26, 1999, the shareholders approved an amendment to the Articles of Incorporation to effect a one-for-four reverse split of the issued and outstanding shares of the Company's \$0.01 par value common stock to holders of record on August 2, 1999. All references in the accompanying financial statements to the per share amounts and the number of shares of common stock, except for shares authorized, for 1998 have been restated to reflect the reverse stock split. Common stock and additional paid-in capital as of June 30, 1999 have been restated to reflect this reverse stock split.

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

Dynex Capital, Inc. (the "Company") is a financial services company that primarily originates mortgage loans secured by multifamily and commercial properties and loans secured by manufactured homes. The Company will generally securitize the loans funded as collateral for collateralized bonds, thereby limiting its credit and liquidity risk and providing long-term financing for its investment portfolio.

#### FINANCIAL CONDITION

<TABLE>  
<CAPTION>

(amounts in thousands except per share data)	June 30,	December 31,
	1999	1998
<S>	<C>	<C>
Investments:		
Collateral for collateralized bonds	\$ 3,811,836	\$ 4,293,528
Securities	209,889	243,984
Other investments	41,972	30,371

Loans held for securitization	405,479	388,782
Non-recourse debt - collateralized bonds	3,373,186	3,665,316
Recourse debt	880,016	1,032,733
Shareholders' equity	437,921	452,804
Book value per common share	26.45	27.75

</TABLE>

#### Collateral for collateralized bonds

Collateral for collateralized bonds consists primarily of securities backed by adjustable-rate and fixed-rate mortgage loans secured by first liens on single family properties, fixed-rate loans secured by first liens on multifamily and commercial properties, manufactured housing installment loans secured by either a UCC filing or a motor vehicle title and property tax receivables. As of June 30, 1999, the Company had 28 series of collateralized bonds outstanding. The collateral for collateralized bonds decreased to \$3.8 billion at June 30, 1999 compared to \$4.3 billion at December 31, 1998. This decrease of \$0.5 billion is primarily the result of \$723.9 million in paydowns on collateral, which was principally offset by the net addition of \$277.7 million of collateral as a result of a \$1.4 billion issuance of collateralized bonds in March 1999, of which \$1.2 billion related to the collapse and re-securitization the collateral from seven series of previously issued collateralized bonds.

#### Securities

Securities consist primarily of fixed-rate "funding notes" secured by automobile installment contracts, adjustable-rate and fixed-rate mortgage-backed securities, and corporate bonds. Securities also include derivative and residual securities. Derivative securities are classes of collateralized bonds, mortgage pass-through certificates or mortgage certificates that pay to the holder substantially all interest (i.e., an interest-only security), or substantially all principal (i.e., a principal-only security). Residual interests represent the right to receive the excess of (i) the cash flow from the collateral pledged to secure related mortgage-backed securities, together with any reinvestment income thereon, over (ii) the amount required for principal and interest payments on the mortgage-backed securities or repurchase arrangements, together with any related administrative expenses. Securities decreased to \$209.9 million at June 30, 1999 compared to \$244.0 million at December 31, 1998. This decrease was primarily the result of \$47.6 million of paydowns and the sale of \$16.0 million of securities during the six months ended June 30, 1999. These decreases were partially offset by the purchase of \$23.5 million of securities during the six months ended June 30, 1999.

#### Other investments

Other investments consists primarily of a note receivable received in connection with the sale of the Company's single family mortgage operations in May 1996 and property tax receivables. Other investments increased from \$30.4 million at December 31, 1998 to \$42.0 million at June 30, 1999. This increase of \$11.6 million is primarily the result of the purchase of \$10.6 million of property tax receivables during the six months ended June 30, 1999.

#### Loans held for securitization

Loans held for securitization increased from \$388.8 million at December 31, 1998 to \$405.5 million at June 30, 1999. This increase was primarily due to new loan fundings from the Company's production operations totaling \$403.1 million during the six months ended June 30, 1999. This increase was partially offset by the securitization of \$277.7 million of loans held for securitization as collateral for collateralized bonds issued during March 1999 and the sale of \$22.0 million of loans held for securitization during the six months ended June 30, 1999.

#### Non-recourse debt

Collateralized bonds issued by Dynex REIT are recourse only to the assets pledged as collateral, and are otherwise non-recourse to Dynex REIT. The collateralized bonds decreased from \$3.7 billion at December 31, 1999 to \$3.4 billion at June 30, 1999. This decrease was primarily a result of paydowns on all collateralized bonds of \$714.6 million during the six months ended June 30, 1999. This decrease was partially offset by Dynex REIT adding \$1.4 billion of collateralized bonds during the six months ended June 30, 1999. Of this \$1.4 billion of collateralized bonds, \$1.0 billion related to the collapse and re-securitization of seven series of collateralized bonds.

#### Recourse debt

Recourse debt decreased to \$0.9 billion at June 30, 1999 from \$1.0 billion at December 31, 1998. This decrease was primarily due to the securitization of \$277.7 million of manufactured housing loans as collateral for collateralized bonds during the six months ended June 30, 1999. These loans were previously financed by \$190.7 million of repurchase agreements and \$57.5 million of notes payable. This decrease was partially offset by the net addition of \$222.7 million of notes payable resulting from additional loan fundings during the six months ended June 30, 1999.

# Shareholders' equity

Shareholders' equity decreased to \$437.9 million at June 30, 1999 from \$452.8 million at December 31, 1998. This decrease was primarily the result of a \$14.2 million increase in the net unrealized loss on investments available-for-sale from \$3.1 million at December 31, 1998 to \$17.3 at June 30, 1999.

## Loan Production Activity (\$ in thousands)

<TABLE>

<CAPTION>

	Three Months Ended June 30,		Six Months Ended June 30,	
	1999	1998	1999	1998
<S>	<C>	<C>	<C>	<C>
Commercial (1) 368,295	\$ 123,126	\$ 164,956	\$ 171,784	\$
Manufactured housing 220,232	129,564	136,284	238,536	
Specialty finance 69,290	41,934	35,887	90,297	
Total fundings through direct production 657,817	294,624	337,127	500,617	
Secured funding notes (2) 38,266	-	38,266	13,654	
Securities acquired through bond calls 455,714	-	166,784	-	
Single family fundings through bulk purchases 562,045	-	-	-	
Total fundings 1,713,842	\$ 294,624	\$ 542,177	\$ 514,271	\$

<FN>

(1) Included in commercial fundings were \$89.2 million and \$77.3 million of multifamily construction loans which closed during the three months ended June 30, 1999 and 1998, respectively, and \$114.4 million and \$110.0 million of multifamily construction loans which closed during the six months ended June 30, 1999 and 1998, respectively. As of June 30, 1999, \$392.2 million of multifamily construction loans have closed, of which only the amount drawn for these loans of \$85.8 million is included in the balance of the loans held for securitization at June 30, 1999.

(2) Secured by automobile installment contracts.

</FN>

</TABLE>

Direct loan production for the six months ending June 30, 1999 totaled \$500.6 million compared to \$657.8 million for the same period in 1998. This decrease in loan production was due to decreased origination volume of commercial loans during 1999. This decreased volume was partially offset by increased origination volume of both manufactured housing loans and specialty finance loans during 1999. In addition to the Company's direct loan production, the Company funded \$13.7 million of funding notes during the six months ended June 30, 1999. There were no bulk purchases or bond calls during the first six months of 1999 compared to \$562.0 million of bulk purchases and \$455.7 million of bond calls during the same period in 1998.

The Company announced during the second quarter its intentions to sell its manufactured housing lending business operated through its affiliate, Dynex Financial, Inc.

## RESULTS OF OPERATIONS

<TABLE>

<CAPTION>

	Three Months Ended	Six Months
Ended	June 30,	June 30,

(amounts in thousands except per share information) 1998	1999	1998	1999	
<S> <C>	<C>	<C>	<C>	
Net interest margin 34,332	\$ 14,594	\$ 17,186	\$ 25,807	\$
Equity in net (loss) earnings of Dynex Holding, Inc. 2,007	290	1,616	(79)	
(Loss) gain on sale of investments and trading activities 7,728	(5,541)	3,264	(6,467)	
General and administrative expenses 4,121	1,961	1,746	3,969	
Net administrative fees and expenses to Dynex Holding, Inc. 11,060	5,366	5,447	11,290	
Net income 30,031	3,574	15,599	5,833	
Basic net income (loss) per common share 2.06	\$ 0.03	\$ 1.08	\$ (0.05)	\$
Diluted net income (loss) per common share 2.06	\$ 0.03	\$ 1.08	\$ (0.05)	\$
Dividends declared per share:				
Common 0.15	\$ -	\$ 0.075	\$ -	\$
Series A and B Preferred 1.20	0.585	0.600	1.17	
Series C Preferred 1.46	0.730	0.730	1.46	

Three and Six Months Ended June 30, 1999 Compared to Three and Six Months Ended June 30, 1998. The decrease in net income and net income per common share during the three and six months ended June 30, 1999 as compared to the same period in 1998 is primarily the result of a decrease in net interest margin and a decrease in the gain on sale of investments and trading activities.

Net interest margin for the six months ended June 30, 1999 decreased to \$25.8 million, or 25% below the \$34.3 million for the same period for 1998. Net interest margin for the three months ended June 30, 1999 decreased to \$14.6 million, or 15%, below the \$17.2 million for the same period for 1998. These decreases were primarily the result of the decline in average interest-earning assets from \$5.8 billion and \$5.5 billion for the three and six months ended June 30, 1998, respectively, to \$4.6 billion and \$4.7 billion for the three and six months ended June 30, 1999, respectively. In addition, provision for losses increased to \$7.6 million or 0.32% on an annualized basis of average interest-earning assets during the six months ended June 30, 1999 compared to \$3.2 million and 0.12% during the six months ended June 30, 1998. Provision for losses increased to \$3.8 million or 0.33% on an annualized basis of average interest-earnings assets during the three months ended June 30, 1999 compared to \$1.7 million and 0.12% during the same period in 1998. This increase in provision for losses was a result of increasing the provision for anticipated losses on the commercial loans that collateralize the securitization issued in December 1998 and increasing the reserves for potential losses on single family and manufactured housing loans.

The net (loss) gain on sale of investments and trading activities for the six months ended June 30, 1999 decreased to a \$6.5 million loss, as compared to a \$7.7 million gain for the same period in 1998. The net (loss) gain on sale of investments and trading activities for the three months ended June 30, 1999 decreased to a \$5.5 million loss, as compared to a \$3.3 million gain for the same period in 1998. The decrease for both the three and six months ended June 30, 1999 is primarily the result of a \$4.5 million loss related to the sale or writedown of \$49.7 million of commercial loans and a \$2.7 million loss primarily related to the write-off of hedge positions on \$64.4 million of commercial loan commitments during the three months ended June 30, 1999. In addition, the Company had a \$1.4 million permanent impairment on certain residual interests during the three months ended June 30, 1999. These decreases were partially offset by a \$1.1 million gain and a \$1.5 million gain on various trading positions closed during the three and six months ended June 30, 1999, respectively, and a \$0.2 million gain related to the sale of \$16.0 million of securities during the first quarter of 1999. The net gain on sale of investments and trading activities for the three and six months ended June 30, 1998 is primarily the result of gains recognized of \$1.4 million and \$5.9 million on various trading positions closed during the three and six months ended June 30, 1998, respectively. In addition, securities with an aggregate principal balance of \$84.5 million were sold during the three months ended June 30, 1998, for an

Net administrative fees and expenses to DHI increased \$0.2 million, or 2%, to \$11.3 million in the six months ended June 30, 1999. This increase is primarily the result of the continued growth in the Company's production operations, primarily in the manufactured housing and specialty finance businesses.

### Average Balances and Effective Interest Rates

\_\_\_\_\_



<FN>

- (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 \$2,274 and \$5,492 for the three months ended June 30, 1999 and 1998, respectively, and \$2,086 and \$3,841 for the six months ended June 30, 1999 and 1998, respectively.
- (3) Effective rates are calculated excluding non-interest related collateralized bond expenses and provision for credit losses.

</FN>

</TABLE>

The net interest spread increased to 1.37% and 1.22% for the three and six months ended June 30, 1999 from 1.17% and 1.18% for the same periods in 1998. This increase was primarily due to a reduction in premium amortization expense, which decreased from \$7.0 million and \$15.5 million for the three and six months ended June 30, 1998, respectively to \$4.8 million and \$10.7 million for the same periods in 1999. The overall yield on interest-earning assets decreased to 7.24% for the three and six months ended June 30, 1999 from 7.61% and 7.60% for the three and six months ended June 30, 1998 while the cost of interest-bearing liabilities decreased to 5.87% and 6.02% for the three and six months ended June 30, 1999, respectively, from 6.44% and 6.42% for the three and six months ended June 30, 1998, respectively.

Individually, the net interest spread on collateral for collateralized bonds increased 41 basis points, from 87 basis points for the six months ended June 30, 1998 to 128 basis points for the same period in 1999. This increase was primarily due to lower premium amortization caused by decreased prepayments during the first half of 1999 compared to the first half of 1998. The net interest spread on securities decreased 262 basis points, from 241 basis points for the six months ended June 30, 1998 to a negative 21 basis points for the six months ended June 30, 1999. This decrease was primarily the result of the sale of certain higher coupon collateral during the third quarter of 1998. In addition, certain assets were placed on non-accrual status subsequent to June 30, 1998. The net interest spread on other investments increased 56 basis points, from 114 basis points for the six months ended June 30, 1998, to 170 basis points for the same period in 1999, due to a higher interest rate paid in 1999 by Dynex Residential, Inc. ("DRI"), an operating subsidiary of DHI, to Dynex REIT in conjunction with DRI's note payable to Dynex REIT related to the Company's single family model home purchase and leaseback business, effective as of January 1, 1999. The net interest spread on loans held for securitization decreased 29 basis points, from 285 basis points for the six months ended June 30, 1998, to 256 basis points for the same period in 1999. This decrease is primarily attributable to the funding or purchase of lower coupon collateral during the six months ended June 30, 1999.

#### Interest Income and Interest-Earning Assets

Average interest-earning assets declined to \$4.6 billion for the three months ended June 30, 1999, a decrease of approximately 20% from \$5.8 billion of average interest-earning assets during the same period of 1998. This decrease in average interest-earning assets was primarily the result of \$1.9 billion of principal payments during the twelve months ended June 30, 1999. In addition, \$263.4 million of investments were sold during the same period. These decreases were partially offset by loans originations of \$1.0 billion for the twelve months ended June 30, 1999. In addition, Dynex REIT purchased \$134.4 million of securities and \$86.6 million of other investments during the twelve months ended June 30, 1999. Total interest income decreased approximately 24%, from \$110.0 million for the three months ended June 30, 1998 to \$84.0 million for the same period of 1999. This decrease in total interest income was due to both the decline in average interest-earnings assets and to a decline in the yield on interest-earning assets. Overall, the yield on interest-earning assets declined to 7.24% for the three months ended June 30, 1999 from 7.61% for the three months ended June 30, 1998, due primarily to an overall decrease in interest rates during the latter half of 1998 and the first quarter of 1999.

On a quarter to quarter basis, average interest-earning assets for the quarter ended June 30, 1999 were \$4.6 billion versus \$4.8 billion for the quarter ended March 31, 1999. This decrease in average interest-earning assets was primarily the result of \$361.6 million of principal payments during the quarter ended June 30, 1999. This decrease was partially offset by \$294.6 million of loans funded through the production operations or otherwise purchased. Total interest income for the quarter ended June 30, 1999 was \$84.0 million versus \$87.1 million for the quarter ended March 31, 1999. This decrease in total interest income was due primarily to the decrease in interest-earning assets.

Earning Asset Yield  
(\$ in millions)

<TABLE>  
<CAPTION>

	Average Interest- Earning Assets	Interest Income (2)	Average Interest- Earnings Asset Yield
<S>	<C>	<C>	<C>
1997, Quarter 3	\$ 4,801.2	\$ 91.8 (1)	7.65%
1997, Quarter 4	5,143.0	99.2 (1)	7.72%
1998, Quarter 1	5,120.2	97.2	7.59%
1998, Quarter 2	5,780.5	110.0	7.61%
1998, Quarter 3	5,571.7	104.5 (1)	7.50%
1998, Quarter 4	5,138.3	95.9	7.46%
1999, Quarter 1	4,817.5	87.1	7.24%
1999, Quarter 2	4,639.6	84.0	7.24%

<FN>

- (1) Interest income includes amounts related to the gross interest income on certain securities which are accounted for net of the related interest expense.  
(2) Interest income excludes amounts related to the net interest income on advances to DHI.

</FN>

</TABLE>

Approximately \$2.0 billion of the investment portfolio as of June 30, 1999 is comprised of loans or securities that have coupon rates which adjust over time (subject to certain periodic and lifetime limitations) in conjunction with changes in short-term interest rates. Approximately 63% of the ARM loans underlying the ARM securities and collateral for collateralized bonds are indexed to and reset based upon the level of six-month LIBOR; approximately 27% are indexed to and reset based upon the level of the one-year Constant Maturity Treasury (CMT) index. The following table presents a breakdown, by principal balance, of the Company's collateral for collateralized bonds and ARM and fixed mortgage securities by type of underlying loan. This table excludes other derivative and residual securities, other securities, other investments and loans held for securitization.

Investment Portfolio Composition (1)  
(\$ in millions)

<TABLE>  
<CAPTION>

	LIBOR Based ARM Loans	CMT Based ARM Loans	Other Indicies Based Arm Loans	Fixed-Rate Loans	Total
<S>	<C>	<C>	<C>	<C>	<C>
1998, Quarter 1	\$ 2,128.3	\$ 656.1	\$ 283.3	\$ 1,564.2	\$ 4,631.9
1998, Quarter 2	2,153.5	1,159.8	240.2	1,467.0	5,020.5
1998, Quarter 3	1,873.7	978.3	208.0	1,351.0	4,411.0
1998, Quarter 4	1,644.0	720.4	195.4	1,704.0	4,263.8
1999, Quarter 1	1,411.6	629.8	159.4	1,927.6	4,128.4
1999, Quarter 2	1,239.2	525.4	146.9	1,872.9	3,784.4

<FN>

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

</FN>

</TABLE>

The average asset yield is reduced for the amortization of premiums, net of discounts on the investment portfolio. As indicated in the table below, premiums on the collateral for collateralized bonds, ARM securities, fixed-rate mortgage securities and other securities at June 30, 1999 were \$60.7 million, or approximately 1.59% of the aggregate investment portfolio. Of this \$60.7 million, \$36.4 million relates to the premium on multifamily and commercial mortgage loans that have prepayment lockouts or yield maintenance for at least seven years. Amortization expense as a percentage of principal paydowns has increased from 1.24% for the three months ended June 30, 1998 to 1.42% for the same period in 1999, primarily due to the multifamily and commercial securitization during the fourth quarter of 1998. The principal prepayment rate for the Company (indicated in the table below as "CPR Annualized Rate") was approximately 30% for the three months ended June 30, 1999, which was a decrease from 36% one year ago. CPR or "constant prepayment rate" is a measure of the

annual prepayment rate on a pool of loans. Excluded from this table are the Company's loans held for securitization, which are carried at a net discount of \$9.8 million at June 30, 1999.

Premium Basis and Amortization  
(\$ in millions)

<TABLE>  
<CAPTION>

	Net Premium	Amortization Expense	CPR Annualized Rate	Principal Paydowns	Amortization Expense as a % of Principal Paydowns
<S>	<C>	<C>	<C>	<C>	<C>
1997, Quarter 3	\$ 57.9	\$ 4.8	29%	\$ 258.8	1.85%
1997, Quarter 4	56.9	5.8	37%	319.6	1.80%
1998, Quarter 1	49.5	8.5	47%	546.7	1.56%
1998, Quarter 2	45.7	7.0	36%	563.0	1.24%
1998, Quarter 3	39.0	6.3	40%	603.0	1.05%
1998, Quarter 4	77.8	5.7	41%	502.5	1.12%
1999, Quarter 1	65.4	5.9	38%	402.8	1.46%
1999, Quarter 2	60.7	4.8	30%	338.4	1.42%

Interest Expense and Cost of Funds

Dynex REIT's largest expense is the interest cost on borrowed funds. Funds to finance the investment portfolio are borrowed primarily in the form of non-recourse collateralized bonds or repurchase agreements. The interest rates paid on collateralized bonds are either fixed or floating rates; the interest rates on the repurchase agreements are floating rates. Dynex REIT may use interest rate swaps, caps and financial futures to manage its interest rate risk. The net cost of these instruments is included in the cost of funds table below as a component of interest expense for the period to which they relate. Average borrowed funds decreased from \$5.5 billion for the three months ended June 30, 1998 to \$4.4 billion for the same period in 1999. This decrease resulted primarily from the decline in interest-earning assets of \$1.1 billion during the twelve months ended June 30, 1999 and the paydown of the related borrowings. For the three months ended June 30, 1999, interest expense decreased to \$64.1 million from \$88.8 million for the three months ended June 30, 1998, while the average cost of funds decreased to 5.87% for the three months ended June 30, 1999 compared to 6.44% for the same period in 1998. The decreased average cost of funds for the second quarter of 1999 compared to the second quarter of 1998 was mainly a result of a decrease in the one-month LIBOR rate during the latter half of 1998.

Cost of Funds  
(\$ in millions)

<TABLE>  
<CAPTION>

	Average Borrowed Funds	Interest Expense (1) (2)	Cost of Funds
<S>	<C>	<C>	<C>
1997, Quarter 3	\$ 4,357.9	\$ 68.8	6.31%
1997, Quarter 4	4,570.3	74.1	6.49%
1998, Quarter 1	4,791.1	76.6	6.40%
1998, Quarter 2	5,520.7	88.8	6.44%
1998, Quarter 3	5,377.7	86.0	6.39%
1998, Quarter 4	4,941.6	75.7	6.13%
1999, Quarter 1	4,576.7	70.6	6.17%
1999, Quarter 2	4,371.3	64.1	5.87%

<FN>

- (1) Excludes non-interest collateralized bond-related expenses.  
(2) Includes the net amortization expense of bond discounts and bond premiums.

</FN>  
</TABLE>

Interest Rate Agreements

As part of the asset/liability management process for its investment portfolio, Dynex REIT may enter into interest rate agreements such as interest

rate caps, swaps and financial futures contracts. These agreements are used to reduce interest rate risk which arises from the lifetime yield caps on the ARM securities, the mismatched repricing of portfolio investments versus borrowed funds, the funding of fixed interest rates on certain portfolio investments with floating rate borrowings and finally, assets repricing on indices such as the prime rate which differ from the related borrowing indices. The agreements are designed to protect the portfolio's cash flow and to provide income and capital appreciation to Dynex REIT in the event that short-term interest rates rise quickly.

The following table includes all interest rate agreements in effect as of the various quarter ends for asset/liability management of the investment portfolio. This table excludes all interest rate agreements in effect for the loan production operations as generally these agreements are used to hedge interest rate risk related to forward commitments to fund loans. Generally, interest rate swaps and caps are used to manage the interest rate risk associated with assets that have periodic and annual interest rate reset limitations financed with borrowings that have no such limitations. Amounts presented are aggregate notional amounts. To the extent any of these agreements are terminated, gains and losses are generally amortized over the remaining period of the original agreement.

Instruments Used for Interest Rate Risk Management Purposes (1)  
(Notional Amounts in millions)

<TABLE>  
<CAPTION>

	Interest Rate Caps	Interest Rate Swaps
<S>	<C>	<C>
1997, Quarter 3	\$ 1,599	\$ 1,381
1997, Quarter 4	1,599	1,354
1998, Quarter 1	1,599	1,559
1998, Quarter 2	1,599	1,726
1998, Quarter 3	1,599	1,561
1998, Quarter 4	1,599	1,140
1999, Quarter 1	1,364	1,122
1999, Quarter 2	1,364	1,105

<FN>

(1) Excludes all interest rate agreements in effect for the Company's loan production operations.

</FN>  
</TABLE>

#### Net Interest Rate Agreement Expense

The net interest rate agreement expense, or hedging expense, equals the cost of the agreements presented in the previous table, net of any benefits received from these agreements. For the quarter ended June 30, 1999, net hedging expense amounted to \$1.09 million compared to \$1.12 million and \$1.83 million for the quarters ended March 31, 1999 and June 30 1998, respectively. Such amounts exclude the hedging costs and benefits associated with the Company's production activities as these amounts are deferred as additional premium or discount on the loans funded and amortized over the life of the loans as an adjustment to their yield. The net interest rate agreement expense decreased for the three months ended June 30, 1999 compared to the same period in 1998, primarily due to the expiration of \$235 million of interest rate caps in January 1999. In addition, the Company terminated \$75.4 million of interest rate swap agreements for a total loss of \$0.2 million during the first half of 1999 as the collateral which the interest rate swap was hedging was amortizing at a faster rate than the original swap. This loss is being amortized into interest income over the estimated remaining life of the collateral as a yield adjustment.

Net Interest Rate Agreement Expense  
(\$ in millions)

<TABLE>  
<CAPTION>

	Net Interest Rate Agreement Expense	Net Expense as Percentage of Average Assets (annualized)	Net Expense as Percentage of Average Borrowings (annualized)
<S>	<C>	<C>	<C>
1997, Quarter 3	\$ 1.35	0.11%	0.12%
1997, Quarter 4	1.39	0.11%	0.12%

1998, Quarter 1	1.23	0.10%	0.10%
1998, Quarter 2	1.83	0.13%	0.13%
1998, Quarter 3	1.92	0.14%	0.14%
1998, Quarter 4	1.72	0.13%	0.14%
1999, Quarter 1	1.12	0.09%	0.10%
1999, Quarter 2	1.09	0.09%	0.10%

</TABLE>

#### Fair Value

The fair value of the available-for-sale portion of the investment portfolio as of June 30, 1999, as measured by the net unrealized loss on investments available-for-sale, was \$17.3 million below its cost basis, which represents a \$14.2 million decrease from December 31, 1998. At December 31, 1998, the fair value of the investment portfolio was \$3.1 million below its amortized cost basis. This decrease in the portfolio's value is primarily attributable to prepayments on the portfolio, the recent 25 basis point increase in the targeted Fed Funds rate and the approximately 80 basis point increase in longer term interest rates during the six months ended June 30, 1999.

#### Credit Exposures

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

The following table summarizes the aggregate principal amount of collateral for collateralized bonds and pass-through securities outstanding; the maximum direct credit exposure retained by the Company (represented by the amount of overcollateralization pledged and subordinated securities rated below BBB owned by the Company), net of the credit reserves maintained by the Company for such exposure; and the actual credit losses incurred for each quarter. The table excludes any risks related to representations and warranties made on loans funded by the Company and securitized in mortgage pass-through securities generally funded prior to 1995. This table also excludes any credit exposure on loans held for securitization (which will be included as the loans are securitized), funding notes and other investments. The increase in net credit exposure as a percentage of the outstanding loan principal balance from 2.36% at June 30, 1998 to 3.92% at June 30, 1999 is related primarily to the credit exposure retained by the Company on its commercial securitization issued during December 1998 and its single family and manufactured housing securitizations issued during March 1999.

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

<TABLE>

<CAPTION>

	Outstanding Loan Principal Balance	Maximum Credit Exposure, Net of Credit Reserves	Actual Credit Losses	Maximum Credit Exposure, Net of Credit Reserves to Outstanding Loan Balance
<S>	<C>	<C>	<C>	<C>
1997, Quarter 3	\$ 3,975.7	\$ 50.2	\$ 5.8	1.26%
1997, Quarter 4	5,153.1	86.6	6.5	1.68%
1998, Quarter 1	4,209.5	93.6	6.3	2.22%
1998, Quarter 2	5,098.8	120.1	3.8	2.36%
1998, Quarter 3	4,440.2	132.4	6.4	2.98%
1998, Quarter 4	4,389.7	159.7	3.8	3.64%
1999, Quarter 1	4,340.8	161.6	4.3	3.72%
1999, Quarter 2	3,965.6	155.5	4.6	3.92%

</TABLE>

The following table summarizes single family mortgage loan, manufactured housing loan and commercial mortgage loan delinquencies as a percentage of the outstanding collateral balance for those securities in which Dynex REIT has retained a portion of the direct credit risk. The increase in delinquencies as a percentage of the outstanding collateral balance of 2.12% at June 30, 1999 is essentially unchanged from the 2.06% at June 30, 1998. The Company monitors and evaluates its exposure to credit losses and has established reserves based upon anticipated losses, general economic conditions and trends in the investment portfolio. As of June 30, 1999, management believes the credit reserves are sufficient to cover anticipated losses which may occur as a result of current delinquencies presented in the table below.

Delinquency Statistics (1)

<TABLE>

<CAPTION>

	60 to 90 days delinquent	90 days and over delinquent (2)	Total
<S>	<C>	<C>	<C>
1997, Quarter 3	0.89%	3.39%	4.28%
1997, Quarter 4	0.51%	2.82%	3.33%
1998, Quarter 1	0.44%	2.65%	3.09%
1998, Quarter 2	0.24%	1.82%	2.06%
1998, Quarter 3	0.39%	1.73%	2.12%
1998, Quarter 4	0.25%	2.11%	2.36%
1999, Quarter 1	0.45%	2.24%	2.69%
1999, Quarter 2	0.30%	1.82%	2.12%

<FN>

(1) Excludes funding notes, other investments and loans held for securitization.

(2) Includes foreclosures, repossessions and REO.

</FN>

</TABLE>

The following table summarizes the credit ratings for collateral for collateralized bonds and securities held in the investment portfolio. This table excludes \$13.8 million of other derivative and residual securities (as the risk on such securities is primarily prepayment-related, not credit-related), other investments and loans held for securitization. This table also excludes the funding notes, aggregating \$116.5 million which are not rated. The balance of the investments rated below A are net of credit reserves and discounts. All balances exclude the related mark-to-market adjustment on such assets. At June 30, 1999, securities with a credit rating of AA or better were \$3.3 billion, or 90.1% of the total.

Investments by Credit Rating (1)  
(\$ in millions)

<TABLE>

<CAPTION>

	AAA/AA Carrying Value	A Carrying Value	BBB Carrying Value	Below BBB Carrying Value	AAA /AA Percent of Total	A Percent of Total	BBB Percent of Total	Below BBB Percent of Total
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
1998, Quarter 1	\$4,369.9	\$ 72.0	\$ 50.0	\$ 3.6	97.2%	1.6%	1.1%	0.1%
1998, Quarter 2	4,729.1	138.5	72.7	7.7	95.6%	2.8%	1.5%	0.1%
1998, Quarter 3	4,126.6	139.3	73.3	5.4	95.0%	3.2%	1.7%	0.1%
1998, Quarter 4	3,815.6	206.2	97.6	14.4	92.3%	5.0%	2.4%	0.3%
1999, Quarter 1	3,614.8	219.2	118.8	24.0	90.9%	5.5%	3.0%	0.6%
1999, Quarter 2	3,282.2	219.4	118.8	21.7	90.1%	6.0%	3.3%	0.6%

<FN>

(1) Carrying value does not include funding notes, derivative and residual securities, other investments and loans held for securitization. Balances also exclude the mark-to-market adjustment. Carrying value also excludes \$221.2 million of overcollateralization at June 30, 1999.

</FN>

</TABLE>

General and Administrative Expenses

General and administrative expenses and net administrative fees and expenses to DHI ("collectively, G&A expense") consist of expenses incurred in conducting the production activities and managing the investment portfolio, as well as various other corporate expenses. G&A expense remained relatively flat for the three month period ended June 30, 1999 as compared to the same period in 1998. The Company expects overall G&A expense levels to remain relatively constant for the remainder of 1999 until the sale of the manufactured housing business.

The following table summarizes the ratio of G&A expense to average interest-earning assets and the ratios of G&A expense to average total equity.

Operating Expense Ratios

<TABLE>

<CAPTION>

	G&A Expense/Average Interest-Earning Assets (Annualized)	G&A Expense/Average Total Equity (Annualized) (1)
<S>	<C>	<C>
1997, Quarter 3	0.43%	4.37%
1997, Quarter 4	0.62%	6.61%
1998, Quarter 1	0.62%	6.59%
1998, Quarter 2	0.50%	5.93%
1998, Quarter 3	0.56%	6.43%
1998, Quarter 4	0.66%	7.23%
1999, Quarter 1	0.66%	6.96%
1999, Quarter 2	0.63%	6.44%

<FN>

(1) Average total equity excludes net unrealized gain (loss) on investments available-for-sale.

</FN>

</TABLE>

#### Net Income and Return on Equity

Net income decreased from \$15.6 million for the three months ended June 30, 1998 to \$3.6 million for the three months ended June 30, 1999. Net income available to common shareholders decreased from \$12.3 million for the three months ended June 30, 1999 to \$0.3 million for the same period, respectively. Return on common equity (excluding the impact of the net unrealized gain on investments available-for-sale) decreased from 13.8% for the three months ended June 30, 1998 to 0.5% for the three months ended June 30, 1999. The decrease in the return on common equity is primarily a result of the decline in net income available to common shareholders from the quarter ended June 30, 1998 to the same period in 1999 and the issuance of new common shares during the second half of 1998.

#### Components of Return on Equity (\$ in thousands)

<TABLE>

<CAPTION>

	Net Interest Margin/ Average	Provision for Losses /Average	Permanent Impairment / Average	Equity Earnings (Loss), Gains (Losses) and Other Income	G&A Expense/ Average	Preferred Dividend/ Average	Return on Average
Net Income	Common Equity	Common	Common	/Average Common	Common	Common Equity	Common
Available to	(annualized)	Equity	Equity	Equity	Equity	(annualized)	Equity
Common		(annualized)	(annualized)	(annualized)	(annualized)		(annualized)
Shareholders							
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
<C>							
1997, Quarter 3	25.9%	1.3%	-	4.8%	6.1%	4.5%	18.8%
\$ 15,784							
1997, Quarter 4	26.2%	1.9%	-	4.9%	9.0%	4.2%	16.0%
14,103							
1998, Quarter 1	20.9%	1.6%	-	5.9%	9.0%	3.7%	12.5%
11,145							
1998, Quarter 2	21.1%	1.9%	-	6.3%	8.0%	3.7%	13.8%
12,323							
1998, Quarter 3	19.0%	2.4%	-	(0.5%)	8.7%	3.7%	3.7%
3,257							
1998, Quarter 4	21.9%	1.2%	(20.8%)	(10.0%)	9.9%	3.8%	(23.8%)
(20,167)							
1999, Quarter 1	18.3%	4.6%	-	(1.3%)	9.7%	3.9%	(1.2%)
(969)							
1999, Quarter 2	22.4%	4.6%	-	(4.5%)	8.9%	3.9%	0.5%
348							

</TABLE>

## Dividends and Taxable Income

Dynex REIT has elected to be treated as a real estate investment trust for federal income tax purposes. The REIT provisions of the Internal Revenue Code require Dynex REIT to distribute to shareholders substantially all of its taxable income, thereby restricting its ability to retain earnings. Dynex REIT may issue additional common stock, preferred stock or other securities in the future in order to fund growth in its operations, growth in its investment portfolio or for other purposes.

Dynex REIT intends to declare and pay out as dividends 100% of its taxable income over time. Dynex REIT's current practice is to declare quarterly dividends; however, no dividends on its common stock have been declared since September 1998. Generally, Dynex REIT strives to declare a quarterly dividend which will result in the distribution of most or all of the taxable income earned during the applicable year. At the time of the dividend announcement, however, the total level of taxable income for the quarter is unknown. Additionally, Dynex REIT has considerations other than the desire to pay out most of its taxable earnings, which may take precedence when determining the level of dividends. The Company believes that any dividends paid in 1999 will not be a return of capital.

### Dividend Summary (\$ in thousands, except per share amounts)

<TABLE>  
<CAPTION>

	Estimated Taxable Net Income (Loss) Available to Common Shareholders	Estimated Taxable Net Income (Loss) Per Common Share	Dividend Declared Per Common Share	Dividend Pay-out Ratio	Estimated Cumulative Undistributed Taxable Income (Loss)
<S>	<C>	<C>	<C>	<C>	<C>
1997, Quarter 3	\$ 10,531	\$ 0.992	\$ 1.38	139%	\$ 9,392
1997, Quarter 4	10,132	0.912	1.40	154%	3,949
1998, Quarter 1	21,970	1.936	1.20	62%	12,293
1998, Quarter 2	11,339	0.980	1.20	122%	9,746
1998, Quarter 3	3,852	0.332	1.00	301%	2,045
1998, Quarter 4	(2,698)	(0.236)	-	-	(653)
1999, Quarter 1	(6,618)	(0.575)	-	-	(7,271)
1999, Quarter 2	5,053	0.439	-	-	(2,218)

</TABLE>

Taxable income differs from the financial statement net income, which is determined in accordance with generally accepted accounting principles ("GAAP"). For the three months ended June 30, 1999, taxable net income per common share exceeded GAAP income per common share principally due to the writedown of certain assets for GAAP purposes which are not available as a deduction for tax purposes. Cumulative undistributed taxable income (loss) represents timing differences in the amounts earned for tax purposes versus the amounts distributed. To the extent this is undistributed taxable income, such amount can be distributed for tax purposes in the subsequent year as a portion of the normal quarterly dividend. The above amounts include certain estimates of taxable income until such time that Dynex REIT files its federal income tax returns for each year.

## Recent Accounting Pronouncements

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



all fiscal years beginning after June 15, 2000. The Company is in the process of determining the impact of adopting FAS No. 133.

#### Year 2000

The Company is dependent upon purchased, leased, and internally-developed software to conduct certain operations. In addition, the Company relies upon certain counterparties such as banks and loan servicers who are also highly dependent upon computer systems. The Company recognizes that some computer software may incorrectly recognize dates beyond December 31, 1999. The ability of the Company and its counterparties to correctly operate computer software in the Year 2000 is critical to the Company's operations.

The Company uses several major and minor computer systems to conduct its business operations. The computer systems deemed most important to the Company's ability to continue operations are as follows:

- The internally-developed loan origination system for manufactured housing operations
- The internally-developed loan origination and asset management system for commercial loans
- The internally-developed investment portfolio analytics, securitization, and securities administration software
- The purchased servicing system for commercial loans
- The purchased servicing system for single family and manufactured housing loans
- The purchased general ledger accounting system

In addition, the Company is involved in data interchange with a number of counterparties in the normal course of business. Each system or interface that the Company relies on is being tested and evaluated for Year 2000 compliance.

The Company has contacted all of its key software vendors to determine their Year 2000 readiness. The Company has received documentation from each of the vendors providing assurances of Year 2000 compliance:

- Baan/CODA, vendor of the general ledger accounting system, has provided confirmation that their current software release is fully Year 2000 compliant.
- Synergy Software, vendor of the commercial loan servicing system, has provided confirmation that the current release of their software is fully Year 2000 compliant. The Company has installed and performed testing on this version with no issues discovered.
- Interling Software, vendor of the single family and manufactured housing loan servicing software, has provided assurance that their software is Year 2000 compliant.

All software developed internally by the Company was designed to be Year 2000 compliant. Nevertheless, the Company established a Year 2000 test-bed to ensure that there were no design or development oversights that could lead to a Year 2000 problem. Initial testing of all key applications was completed in January of 1999, with only minor issues discovered and subsequently remedied. Critical application testing was completed in June of 1999, and new or upgraded applications will continue to be tested as required through the century date change.

The Company has reviewed or is reviewing the Year 2000 progress of its primary financial counterparties. Based on initial reviews, these counterparties are expected to be in compliance. The Company, as master servicer of certain securities, is in the process of assessing the Year 2000 readiness of its external servicers, to ensure that these parties will be able to correctly remit loan information and payments after December 31, 1999.

The Company believes that, other than its exposure to financial counterparties, its most significant risk with respect to internal or purchased software is the software systems used to service manufactured housing loans. The Company will not be able to service these loans without the automated system. Should these loans go unattended for a period greater than three months, the result could have a material adverse impact on the Company.

The Company is also at significant risk if the systems of the financial institutions that provide the Company financing and software for cash management services should fail. In a worst case scenario, the Company would be unable to fund its operations or pay on its obligations for an unknown period of failure. This would have a material adverse impact on the Company.

The Company is also at significant risk if the voice and data communications network supplied by its provider should fail. In such an instance

the Company would be unable to originate or efficiently service its manufactured housing loans until the problem is remedied. The Company is closely monitoring the Year 2000 efforts of its telecommunications provider; the provider has provided assurance that their network is fully compliant at this time.

The Company is also at significant risk should the electric utility company for the Company's offices in Glen Allen, Virginia, fail to provide power for several business days. In such an instance, the Company would be unable (i) to communicate over its telecommunication systems, (ii) would be unable to process data, and (iii) would be unable to originate or service loans until the problem is remedied. The Company continues to monitor the Year 2000 status of its utility provider, whose plan is scheduled to be completed in the fall of 1999.

The Company uses many other systems (including systems that are not information technology oriented), both purchased and developed internally, that could fail to perform accurately after December 31, 1999. Management believes that the functions performed by these systems are either non-critical or could be performed manually in the event of failure.

The Company has substantially completed its Year 2000 remediation efforts. Management believes that there is little possibility of a significant disruption in business. The major risks are those related to the ability of vendors and business partners to complete Year 2000 plans. The Company expects that those vendors and counterparties will complete their Year 2000 compliance programs before January 1, 2000.

The Company has incurred less than \$75,000 in costs to date in carrying out its Year 2000 compliance program. The Company estimates that it will spend less than \$100,000 to complete the plan. Costs could increase in the event that the Company determines that a counterparty will not be Year 2000 compliant.

The Company is still developing contingency plans in the event that a counterparty is not Year 2000 compliant. These plans will be developed by September 30, 1999.

#### LIQUIDITY AND CAPITAL RESOURCES

The Company finances its operations from a variety of sources. These sources include cash flow generated from the investment portfolio, including net interest income and principal payments and prepayments, common stock offerings through the dividend reinvestment plan, short-term warehouse lines of credit with commercial and investment banks, repurchase agreements and the capital markets via the asset-backed securities market (which provides long-term non-recourse funding of the investment portfolio via the issuance of collateralized bonds). Historically, cash flow generated from the investment portfolio has satisfied its working capital needs, and the Company has had sufficient access to capital to fund its loan production operations, on both a short-term (prior to securitization) and long-term (after securitization) basis. However, if a significant decline in the market value of the investment portfolio that is funded with recourse debt should occur, the available liquidity from these other borrowings may be reduced. As a result of such a reduction in liquidity, the Company may be forced to sell certain investments in order to maintain liquidity. If required, these sales could be made at prices lower than the carrying value of such assets, which could result in losses.

In order to grow its equity base, Dynex REIT may issue additional capital stock. Management strives to issue such additional shares when it believes existing shareholders are likely to benefit from such offerings through higher earnings and dividends per share than as compared to the level of earnings and dividends Dynex REIT would likely generate without such offerings. During the first six months of 1999, Dynex REIT issued 1,381 shares of its common stock pursuant to its dividend reinvestment program for preferred stockholders for net proceeds of \$26 thousand.

Certain aspects of Dynex REIT's funding strategies subject it to liquidity risk. Liquidity risk stems from Dynex REIT's use of repurchase agreements, its use of committed lines of credit with mark-to-market provisions and the reliance on the asset-backed securitization markets for its long-term funding needs. Liquidity risk also stems from hedge positions the Company may take to hedge its commercial and manufactured housing loan production. Repurchase agreements are generally provided by investment banks, and subject Dynex REIT to margin call risk if the market value of assets pledged as collateral for the repurchase agreements declines. Dynex REIT has established 'target equity' requirements for each type of investment pledged as collateral, taking into account the price volatility and liquidity of each such investment. Dynex REIT strives to maintain enough liquidity to meet anticipated margin calls if interest rates increased up to 300 basis points in a twelve-month period.

Dynex REIT has committed lines of credit and uncommitted repurchase facilities to finance the accumulation of assets for securitization. Dynex REIT borrows on these lines of credit on a short-term basis to support the accumulation of assets prior to the issuance of collateralized bonds. These borrowings may bear fixed or variable interest rates, may require additional

collateral in the event that the value of the existing collateral declines, and may be due on demand or upon the occurrence of certain events. If borrowing costs are higher than the yields on the assets financed with such funds, Dynex REIT's ability to acquire or fund additional assets may be substantially reduced and it may experience losses. Dynex REIT currently has a total of \$1.0 billion of committed lines of credit to finance loans held for securitization and other investments. These borrowings are paid down as Dynex REIT securitizes or sells assets. Generally these borrowings allow for the warehousing of assets for a period of 180-365 days. Dynex REIT generally intends to securitize assets by product type every 120-365 days. If there exists a dislocation or disruption in the asset-backed market, Dynex REIT may be unable to securitize the assets, or may only be able to securitize the assets on unfavorable terms. In such a case, Dynex REIT would be required to repay the lines of credit with either available liquidity or would be required to liquidate the assets or other assets to generate liquidity. In addition, lines of credit with commercial and investment banks may include provisions by such banks to mark the collateral to market on a daily basis. To the extent the market value of the associated asset has declined due to market conditions, Dynex REIT may be required to provide additional collateral or sell the associated asset which may result in losses.

As a part of its strategy to hedge exposure to changes in interest rates on commercial mortgage loans funded and commitments to fund commercial mortgage loans, Dynex REIT may enter into forward sales of Treasury futures. Such sales are executed through third parties, which require an initial cash collateral deposit and may require additional cash collateral deposits in the event that movements in interest rates adversely impact the value of the futures position. The value of the related loans or loan commitments will generally increase in value as the futures position decreases; however, such value is generally not recognized until the loans are securitized. In order to maintain its hedge positions, Dynex REIT may therefore be exposed to additional cash collateral requirements in adverse interest rate environments.

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

#### Non-recourse Debt

Dynex REIT, through limited-purpose finance subsidiaries, has issued non-recourse debt in the form of collateralized bonds to fund the majority of its investment portfolio. The obligations under the collateralized bonds are payable solely from the collateral for collateralized bonds and are otherwise non-recourse to Dynex REIT. Collateral for collateralized bonds are not subject to margin calls. The maturity of each class of collateralized bonds is directly affected by the rate of principal prepayments on the related collateral. Each series is also subject to redemption according to specific terms of the respective indentures, generally when the remaining balance of the bonds equals 35% or less of the original principal balance of the bonds. At June 30, 1999, Dynex REIT had \$3.4 billion of collateralized bonds outstanding as compared to \$3.7 billion at December 31, 1998.

#### Recourse Debt

Secured. At June 30, 1999, Dynex REIT had five committed credit facilities aggregating \$1.0 billion, comprised of (i) a \$250 million credit line, expiring in May 2000, from a consortium of commercial banks primarily for the warehousing of multifamily construction and permanent loans (including providing the letters of credit for tax-exempt bonds) and manufactured housing loans, (ii) a \$400 million credit line, expiring in December 1999, from an investment bank primarily for the warehousing of permanent loans on multifamily and commercial properties, (iii) a \$100 million credit line, expiring in December 1999, from an investment bank to fund the purchase of manufactured housing loans, (iv) a \$100 million credit line, expiring in September 1999, from an investment bank for the warehousing of the funding notes and (v) a \$175 million credit line, expiring in August 1999 from a consortium of commercial banks and finance companies to fund the purchase of model homes. The Company has recently entered into an agreement with a finance company to provide additional funding for the purchase of model homes, and expects such finance company to be the source of repayment for the \$175 million credit line maturing in August. Although the Company has held discussions with various lenders to provide the Company with new credit facilities to replace the credit line expiring in September of 1999, the Company as of the date hereof has not been successful in securing replacement financing. However, certain lenders have indicated that their willingness to extend credit to the Company to finance the funding notes is dependent upon the replacement of the existing servicer as the primary servicer on the collateral securing the funding notes. The Company's recourse credit facilities generally contain provisions that a default on any facility is a default on each of the other facilities. If the Company is unable to secure new credit facilities or receive an extension on the existing facilities, the Company would be in default at the respective maturity date of such credit facility. The lines of credit also contain certain financial covenants which Dynex REIT met as of June 30, 1999. However, changes in asset levels or results of operations could result in the violation of one or more covenants in the future.

The following table summarize the committed credit facilities at June 30, 1999. At June 30, 1999, Dynex REIT had \$539.6 million outstanding under its committed credit facilities.

Committed Credit Facilities  
At June 30, 1999  
(\$ in millions)

<TABLE>  
<CAPTION>

Collateral Type	Credit Limit	Current Outstanding Borrowings	Balance of Pledged Collateral	Expiration of Facility
<S>	<C>	<C>	<C>	<C>
Various (primarily commercial and manufactured housing)	\$ 250.0	\$130.0	\$187.1	May 2000
Commercial	400.0	89.0	135.0	December 1999
Manufactured housing	100.0	61.1	69.4	December 1999
Funding notes	100.0	88.3	135.1	September 1999
Model homes	175.0	172.0	199.6	August 1999
	1,025.0	540.4	726.2	
Less: deferred facility expenses	-	(0.8)	-	
Total	\$ 1,025.0	\$539.6	\$726.2	

</TABLE>

Dynex REIT also uses repurchase agreements to finance a portion of its investments, which generally have thirty day maturities. Repurchase agreements allow Dynex REIT to sell investments for cash together with a simultaneous agreement to repurchase the same investments on a specified date for a price which is equal to the original sales price plus an interest component. At June 30, 1999, outstanding obligations under all repurchase agreements totaled \$216.2 million compared to \$528.3 million at December 31, 1998. The following table summarizes the outstanding balances of repurchase agreements by credit rating of the related assets pledged as collateral to support such repurchase agreements. The table excludes repurchase agreements used to finance loans held for securitization.

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

<TABLE>  
<CAPTION>

	AAA	AA	A	BBB	Below BBB	Total
<S>	<C>	<C>	<C>	<C>	<C>	<C>
1998, Quarter 3	\$ 560.8	\$ 91.2	\$ 58.7	\$ 51.9	\$ -	\$ 762.6
1998, Quarter 4	124.5	109.5	91.4	65.6	-	391.0
1999, Quarter 1	86.3	63.2	64.2	57.9	-	271.7
1999, Quarter 2	79.8	31.7	49.5	55.2	-	216.2

</TABLE>

Increases in short-term interest rates, long-term interest rates, or market risk could negatively impact the valuation of securities and may limit Dynex REIT's borrowing ability or cause various lenders to initiate margin calls for securities financed using repurchase agreements. Additionally, certain investments are classes of securities rated AA, A, or BBB that are subordinated to other classes from the same series of securities. Such subordinated classes may have less liquidity than securities that are not subordinated and the value of such classes is more dependent on the credit rating of the related insurer or the credit performance of the underlying loans. In instances of a downgrade of an insurer or the deterioration of the credit quality of the underlying collateral, Dynex REIT may be required to sell certain investments in order to maintain liquidity. If required, these sales could be made at prices lower than the carrying value of the assets, which could result in losses.

Unsecured. Since 1994, Dynex REIT has issued three series of unsecured notes payable totaling \$150 million. The proceeds from these issuances have been used to reduce short-term debt related to financing loans held for

securitization during the accumulation period as well as for general corporate purposes. These notes payable had an outstanding balance at June 30, 1999 of \$123.0 million. The Company has \$97.0 million outstanding of its July 2002 senior notes (the "2002 Notes") and \$26.0 million outstanding on notes issued in September 1994 (the "1994 Notes"). During the quarter ended June 30, 1999, Dynex REIT extinguished \$2.75 million of the 2002 Notes resulting in a \$0.6 million extraordinary gain. Effective May 15, 1999, the Company completed a restructuring of the 1994 Notes. In return for certain covenant relief related to the fixed-charge coverage requirements of the 1994 Notes, the Company agreed to (i) convert the principal amortization of the 1994 Notes from annual to monthly and (ii) shorten the remaining principal amortization period from 30 months to 16. Monthly amortization of the 1994 Notes through October 1999 approximates \$2.0 million. Monthly amortization for the 1994 Notes from November 1999 through August 2000 approximates \$1.7 million.

Total recourse debt decreased from \$1.0 billion for December 31, 1998 to \$0.9 billion for June 30, 1999. This decrease is primarily due to the \$190.7 million and \$57.5 million reduction on repurchase agreements and notes payable due to the securitization of \$277.7 million securities and loans as collateral for collateralized bonds during March 1999. The decrease was partially offset by the addition of \$222.7 million of notes payable as a result of the purchase or origination of additional assets.

Total Recourse Debt  
(\$ in millions)

<TABLE>  
<CAPTION>

	Total Recourse Debt	Total Recourse Debt to Equity	Fixed Charge Coverage Ratio
<S>	<C>	<C>	<C>
1997, Quarter 3	\$ 1,852.4	3.43%	1.87%
1997, Quarter 4	1,133.5	2.02%	1.77%
1998, Quarter 1	2,425.2	4.41%	1.72%
1998, Quarter 2	1,390.3	2.56%	1.48%
1998, Quarter 3	1,614.5	3.21%	1.28%
1998, Quarter 4	1,032.7	2.28%	0.27%
1999, Quarter 1	781.4	1.73%	1.14%
1999, Quarter 2	880.0	2.01%	1.28%

</TABLE>

Table 1  
Components of Collateral for Collateralized Bonds  
(\$ in thousands)

<TABLE>  
<CAPTION>

	June 30, 1999	December 31, 1998
<S>	<C>	<C>
Collateral for collateralized bonds	\$ 3,731,437	\$ 4,177,592
Allowance for loan losses	(15,096)	(16,593)
Funds held by trustees	1,998	1,104
Accrued interest receivable	22,074	27,834
Unamortized premiums and discounts, net	65,661	81,990
Unrealized gain, net	5,762	21,601
Collateral for collateralized bonds	\$ 3,811,836	\$ 4,293,528

</TABLE>

Table 2  
Principal Balance of Collateral for Collateralized Bonds by Loan Type  
(\$ in thousands)

<TABLE>  
<CAPTION>

	June 30, 1999	December 31, 1998
<S>	<C>	<C>

Single family loans  
ARMS:

1 month LIBOR	\$ 7,648	\$ 9,905
3 month LIBOR	21,799	32,081
6 month LIBOR	1,175,986	1,506,431
Prime	91,797	119,833
6 month CD	47,375	63,649
1 year CMT	532,640	779,960
5 year CMT	-	191
<hr/>		
Total ARMs	1,877,245	2,512,050
Fixed	265,330	310,827
<hr/>		
Total single family	2,142,575	2,822,877
<hr/>		
Manufactured housing loans:		
ARM	13,829	13,288
Fixed	739,703	500,677
<hr/>		
Total manufactured housing	753,532	513,965
<hr/>		
Commercial loans	835,330	840,750
<hr/>		
Total	\$ 3,731,437	\$ 4,177,592
<hr/>		

</TABLE>

Table 3  
Collateral for Collateralized Bonds by Collateral Type  
(\$ in thousands)

<hr/>		
	June 30, 1999	December 31, 1998
<hr/>		
<S>	<C>	<C>
<hr/>		
Single family loans:		
Single family detached	\$ 1,691,470	\$ 2,194,304
Condominium	133,506	175,458
Single family attached	154,696	198,089
Planned unit development	98,014	143,293
Cooperative	32,718	41,633
Other	32,171	70,100
<hr/>		
Total single family	2,142,575	2,822,877
<hr/>		
Manufactured housing loans:		
Single wide	273,532	157,787
Multi-sectional	480,000	356,178
<hr/>		
Total manufactured housing	753,532	513,965
<hr/>		
Commercial loans:		
Multifamily (LIHTC)	521,858	531,233
Office	135,435	136,531
Motel/hotel	58,999	59,414
Industrial	33,905	34,217
Healthcare	30,124	30,342
Mixed use	34,745	28,600
Retail	16,624	16,744
Other	3,640	3,669
<hr/>		
Total commercial	835,330	840,750
<hr/>		
Total	\$ 3,731,437	\$ 4,177,592
<hr/>		

</TABLE>

Table 4  
Repricing Period for Adjustable-Rate Single family and  
Manufactured Housing Collateral  
As of June 30, 1999  
(\$ in thousands)

<hr/>		
	Single- Family	Manufactured Housing
		Total
<hr/>		

<S>	<C>	<C>	<C>
3rd Quarter 1999	\$ 691,033	\$ 507	\$ 691,540
4th Quarter 1999	738,239	946	739,185
1st Quarter 2000	53,329	838	54,167
2nd Quarter 2000	49,644	1,501	51,145
3rd Quarter 2000 and beyond	345,000	10,037	355,037
	\$ 1,877,245	\$ 13,829	\$ 1,891,074

</TABLE>

Table 5  
Commercial Loan Prepayment Protection Periods (1)  
As of June 30, 1999  
(\$ in thousands)

<TABLE>  
<CAPTION>

	Number of Loans	Principal Balance
<S>	<C>	<C>
0 - 4 years	1	\$ 12,703
5 - 10 years	27	112,188
11 - 16 years	200	656,774
Over 16 years	9	53,665
	237	\$ 835,330

<FN>

(1) The greater of prepayment lockout period or the yield maintenance period.

</FN>

</TABLE>

Table 6  
Margin of Single Family Loans over Indices

<TABLE>  
<CAPTION>

	June 30, 1999	December 31, 1998
<S>	<C>	<C>
Single family ARM loans		
1 month LIBOR	3.24%	3.24%
3 month LIBOR	3.07	2.87
6 month LIBOR	3.05	3.06
Prime (1)	2.48	2.48
6 month CD	2.50	2.50
1 year CMT	2.85	2.85
5 year CMT	-	2.88
Total single family ARM loans (weighted-average)	2.82	2.82
Manufactured housing loans (6-month LIBOR)	5.80	5.80
Weighted average gross margin	2.84%	2.83%

<FN>

(1) Relative to 1-month LIBOR, after giving effect to the Prime/LIBOR swap owned by the Company.

</FN>

</TABLE>

Table 7  
Weighted Average Coupon for Collateral for Collateralized Bonds

<TABLE>  
<CAPTION>

	June 30, 1999	December 31, 1998
<S>	<C>	<C>

Single family loans:		
ARM loans	7.97%	8.38%
Fixed	9.91	9.82
<hr/>		
Total	8.21	8.54
Manufactured housing loans:		
ARM loans	9.46	9.48
Fixed	8.70	9.07
<hr/>		
Total	8.72	9.08
Commercial loans	8.01	8.01
<hr/>		
Aggregate weighted average coupon	8.27%	8.50%
<hr/>		

</TABLE>

Table 8  
Estimated Call Date and Weighted Average Coupon for Collateralized Bonds  
As of June 30, 1999  
(\$ in thousands)

	Remaining Principal	Bond Type	Current WAC	Current Estimated Call Date
<hr/>				
<S>	<C>	<C>	<C>	<C>
<hr/>				
Commercial Capital Access One, Inc.:				
Series 1	\$ 88,358	Fixed	8.47%	June 2008
Series 2	231,247	Fixed	6.73%	October 2012
Series 3	359,221	Fixed	6.60%	February 2009
Merit Securities Corporation:				
Series 10	492,381	Floating	5.50%	August 1999
Series 11	934,856	Floating	5.32%	November 2000
Series 12-1	316,742	Fixed	6.55%	March 2004
Series 12-2	923,079	Floating	5.52%	May 2001
Other Collateralized Bonds	21,475	Fixed	9.11%	July 1999 to May 2006
Bond premium	7,928			
Unamortized debt issuance costs	(9,180)			
Accrued interest payable	7,079			
<hr/>				
Total Collateralized Bonds	\$ 3,373,186			
<hr/>				

</TABLE>

Table 9  
Net Balance Sheet (1)  
(\$ in thousands)

	June 30, 1999	December 31, 1998
<hr/>		
<S>	<C>	<C>
<hr/>		
ASSETS		
Investments:		
Collateral for collateralized bonds	\$ 3,811,836	\$ 4,293,528
Less: Collateralized bonds issued	(3,583,061)	(4,062,089)
<hr/>		
Net investment in collateralized bonds	228,775	231,439
Collateralized bonds retained	208,569	389,842
Securities	209,889	243,984
Other investments	41,972	30,371
Loans held for securitization	405,479	388,782
<hr/>		
	1,094,684	1,284,418



Investment in and advances to Dynex Holding, Inc.	183,083	169,384
Cash	34,908	30,103
Accrued interest receivable	4,141	9,093
Other assets	19,461	18,488

\$ 1,336,279	\$ 1,511,486
--------------	--------------

#### LIABILITIES AND SHAREHOLDERS' EQUITY

##### Liabilities:

Repurchase agreements	\$ 216,201	\$ 528,283
Notes payable	663,815	502,450
Accrued interest payable	6,154	8,403
Other liabilities	8,958	16,318
Dividends payable	3,228	3,228
	898,356	1,058,682

##### Shareholders' Equity:

Preferred stock, par value \$.01 per share, 50,000,000 shares authorized:		
9.75% Cumulative Convertible Series A		
1,309,061 and 1,309,061 issued and outstanding, respectively	29,900	29,900
9.55% Cumulative Convertible Series B		
1,912,434 and 1,912,434 issued and outstanding, respectively	44,767	44,767
9.73% Cumulative Convertible Series C		
1,840,000 and 1,840,000 issued and outstanding, respectively	52,740	52,740
Common stock, par value \$.01 per share, 100,000,000 shares authorized,		
11,508,237 (2) and 46,027,426 issued and outstanding, respectively	115	460
Additional paid-in capital	352,684	352,382
Accumulated other comprehensive loss	(17,316)	(3,097)
Accumulated deficit	(24,969)	(24,348)
	437,921	452,804
	\$ 1,336,277	\$ 1,511,486

<FN>

- (1) This presents the balance sheet where the collateralized bonds are "netted" against the collateral for collateralized bonds. This presentation better illustrates the Company's net investment in the collateralized bonds and the collateralized bonds retained for its investment portfolio.
- (2) Reflects the one-for-four reverse common stock split which will be effected on August 2, 1999

</FN>

</TABLE>

#### 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. Such forward-looking statements may involve factors that could cause the actual results of the Company to differ materially from historical results or from any results expressed or implied by such forward-looking statements. The Company cautions the public not to place undue reliance on forward-looking statements, which may be based on assumptions and anticipated events that do not materialize. The Company does not undertake, and the Securities Litigation Reform Act specifically relieves the Company from, any obligation to update any forward-looking statements.

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

**Economic Conditions.** The Company is affected by consumer demand for manufactured housing, multifamily housing and other products which it finances. A material decline in demand for these products and services would result in a reduction in the volume of loans originated by the Company. The risk of defaults and credit losses could increase during an economic slowdown or recession. This could have an adverse effect on the Company's financial performance and the performance on the Company's securitized loan pools.

**Capital Resources.** The Company relies on various credit facilities and repurchase agreements with certain commercial and investment banking firms to help meet the Company's short-term funding needs. The Company believes that as these agreements expire, they will continue to be available or will be able to be replaced; however no assurance can be given as to such availability or the prospective terms and conditions of such agreements or replacements. If such

financing is not available or the Company is unable to replace existing credit facilities upon their maturity, the Company's future results could vary materially with its historical results.

**Capital Markets.** The Company relies on the capital markets for the sale upon securitization of its collateralized bonds or other types of securities. While the Company has historically been able to sell such collateralized bonds and securities into the capital markets, there can be no assurances that circumstances relating either to the Company or the capital markets may limit or preclude the ability of the Company to sell such collateralized bonds or securities in the future.

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

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

**Prepayments.** Prepayments by borrowers on loans securitized by the Company may have an adverse impact on the Company's financial performance. Prepayments are expected to increase during a declining interest rate or flat yield curve environment. The Company's exposure to rapid prepayments is primarily (i) the faster amortization of premium on the investments and, to the extent applicable, amortization of bond discount, and (ii) the replacement of investments in its portfolio with lower yield securities. At June 30, 1999, the yield curve had steepened, and as a result, the Company expects a decline of prepayment rates during the third quarter in 1999.

**Competition.** The financial services industry is a highly competitive market. Increased competition in the market could adversely affect the Company's market share within the industry and hamper the Company's efforts to expand its production sources.

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

**New Production Sources.** The Company has expanded both its manufactured housing and commercial lending businesses. The Company is incurring or will incur expenditures related to the start-up of these businesses, with no guarantee that production targets set by the Company will be met or that these businesses will be profitable. Various factors such as economic conditions, interest rates, competition and the lack of the Company's prior experience in these businesses could all impact these new production sources.

### 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 the Company's market risk management extends beyond derivatives to include all market risk sensitive financial instruments. As a financial services company, net interest income comprises the primary component of the Company's earnings. As a result, the Company is subject to risk resulting from interest rate fluctuations to the extent that there is a gap between the amount of the Company's interest-earning assets and the amount of interest-bearing liabilities that are prepaid, mature or reprice within specified periods. The Company's strategy is to mitigate interest rate risk through the creation of a diversified investment portfolio of high quality assets that, in the aggregate, preserves the Company's capital base while

generating stable income in a variety of interest rate and prepayment environments. In many instances, the investment strategy involves not only the creation of the asset, but also structuring the related securitization or borrowing to create a stable yield profile and reduce interest rate risk.

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

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

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

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

The following table summarizes the Company's net interest margin sensitivity analysis as of June 30, 1999 and March 31, 1999. This analysis represents management's estimate of the percentage change in net interest margin given a parallel shift in interest rates. The "Base" case represents the interest rate environment as it existed as of June 30, 1999 and March 31, 1999. The analysis is heavily dependent upon the assumptions used in the model. The effect of changes in future interest rates, the shape of the yield curve or the mix of assets and liabilities may cause actual results to differ from the modeled results. In addition, certain financial instruments provide a degree of "optionality." The model considers the effects of these embedded options when projecting cash flows and earnings. The most significant option affecting the Company's portfolio is the borrowers' option to prepay the loans. The model uses a dynamic prepayment model that applies a Constant Prepayment Rate (CPR) ranging from 6.0% for fixed-rate manufactured housing loans to 69.1% for single family ARM loans indexed to the six month certificate of deposit rate. The model varies the CPR based on the projected incentive to refinance for each loan type in any given period. While the Company's model considers these factors, the extent to which borrowers utilize the ability to exercise their option may cause actual results to significantly differ from the analysis. Furthermore, its projected results assume no additions or subtractions to the Company's portfolio, and no change to the Company's liability structure. Historically, the Company has made significant changes to its assets and liabilities, and is likely to do so in the future. Therefore, the following estimates should not be viewed as a forecast and no assurance can be given that actual results will not vary significantly from the analysis below.

<TABLE>  
<CAPTION>

Basis Point Increase (Decrease) in Interest Rates Over 12 Months	% Change in Net Interest Margin from Base Case	
	June 30, 1999	March 31, 1999
	<C>	<C>
<S>		
+200	(12.17)%	(13.59)%
+100	(6.32)%	(6.77)%
Base	-	-

-100	5.52%	6.97%
-200	11.60%	14.57%

</TABLE>

The June 30, 1999 analysis illustrates that net interest margin is less sensitive to interest rate changes than it was at March 31, 1999. This change is primarily the result of a larger portion of the Company's investment portfolio being comprised of fixed rate assets. At June 30, 1999, 56% of the Company's investment portfolio was fixed rate assets compared to 51% at March 31, 1999.

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

Approximately \$2.0 billion of the Company's investment portfolio as of June 30, 1999 is comprised of loans or securities that have coupon rates which adjust over time (subject to certain periodic and lifetime limitations) in conjunction with changes in short-term interest rates. Approximately 63% and 27% of the ARM loans underlying the Company's ARM securities and collateral for collateralized bonds are indexed to and reset based upon the level of six-month LIBOR and one-year CMT, respectively.

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

Because of the 1% or 2% periodic cap nature of the ARM loans underlying the ARM securities, these securities may decline in market value in a rising interest rate environment. In a rapidly increasing rate environment, as was experienced in 1994, a decline in value may be significant enough to impact the amount of funds available under repurchase agreements to borrow against these securities. In order to maintain liquidity, the Company may be required to sell certain securities. To mitigate this potential liquidity risk, the Company strives to maintain excess liquidity to cover any additional margin required in a rapidly increasing interest rate environment, defined as a 3% increase in short-term interest rates over a twelve-month time period. Liquidity risk also exists with all other investments pledged as collateral for repurchase agreements, but to a lesser extent.

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

The Company may also utilize futures and options on futures to moderate the risks inherent in the financing of a portion of its investment portfolio with floating-rate repurchase agreements. The Company uses these instruments to synthetically lengthen the terms of repurchase agreement financing, generally from one to three or six months. Interest rate futures and option agreements have historically provided the Company a means of essentially locking-in

borrowing costs at specified rates for specified period of time. Under these contracts, the Company will receive additional cash flow if the underlying index increases above contracted rates, mitigating the net interest income loss that results from the higher repurchase agreement rates. The Company will pay additional cash flow if the underlying index decreases below contracted rates. The Company has not utilized futures or options on futures for this purpose since 1997, as they primarily benefit the Company when expected rates as measured by the forward yield-curve are less than current cash market rates.

The remaining portion of the Company's investments portfolio as of June 30, 1999, approximately \$2.5 billion, is comprised of loans or securities that have coupon rates that are either fixed or do not reset within the next 15 months. The Company has limited its interest rate risk on such investments through (i) the issuance of fixed-rate collateralized bonds and notes payable, and (ii) equity, which in the aggregate totals approximately \$1.5 billion as of the same date. The Company's interest rate risk is primarily related to the rate of change in short term interest rates, not the level of short term interest rates.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

As disclosed in previous filings, Dynex Capital, Inc. (the "Company" or "Dynex") filed suit against AutoBond Acceptance Corporation (Amex: ABD) and AutoBond Master Funding Corporation V ("Funding"), a wholly-owned subsidiary of AutoBond, collectively "AutoBond", in the Federal district court of the Eastern District of Virginia seeking declaratory relief with respect to its rights and obligations under various agreements (the "Agreements") by and between the Company AutoBond. AutoBond is a specialty consumer finance company that underwrites, acquires, services and securitizes retail installment contracts originated by automobile dealers to borrowers that are credit impaired. AutoBond has filed suit against Dynex in the district court of Travis County, Texas alleging breach of contract and other claims relating to the suspension of funding by Dynex of retail installment contracts originated by AutoBond. On May 17, 1999, the Federal district court of the Eastern District of Virginia transferred the case to the Federal district court of the Western District of Texas. No hearing for this action has been scheduled.

On June 4, 1999, Dynex filed a counterclaim in the district court of Travis County to the AutoBond filing alleging, among other things, that Dynex was fraudulently induced into the Agreements, that AutoBond has breached the Agreements in the areas of underwriting, servicing and principal payments, and that AutoBond has breached its fiduciary duties to Dynex. In addition to the June 4, 1999 counterclaim, on June 17, 1999, Dynex filed an application in the district court of Travis County asking the court to enter a temporary injunction prohibiting AutoBond from continuing to exercise unlawful control over loan files and the servicing of loans and ordering of AutoBond to cooperate in the transition of the servicing and the loan files to a substitute servicer. In the application for injunction, Dynex alleges that servicing termination events have occurred pursuant to the Agreements, related to excessive Delinquency Ratios (as that term is defined in the Agreements), various breaches of representations and warranties, and the failure of AutoBond to timely deposit all cash collections.

The Company's counterclaim to AutoBond's action is scheduled to be heard in December 1999, along with AutoBond's claim against Dynex. The Company's injunction hearing is scheduled for the week of August 2, 1999.

As of June 30, 1999, the outstanding balance of the auto loans underlying the funding notes was \$127 million and the Company's carrying value of the funding notes was \$117 million. The funding notes had a weighted average coupon of 7.8% and the underlying auto loan collateral had a weighted average coupon of 19.8%. The funding notes receive all the cash (less applicable servicing fees) received on the auto loans until paid in full.

The Company is subject to various lawsuits as result of its lending activities. The Company does not anticipate that the resolution of such lawsuits will have a material impact on the Company's financial condition.

### Item 2. Changes in Securities and Use of Proceeds

The shareholders approved an amendment to the Company's Articles of Incorporation to effect a one-for-four split of the issued and outstanding shares of common stock which became effective August 2, 1999.

### Item 3. Defaults Upon Senior Securities

Not applicable

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

At the Company's annual meeting of shareholders held on June 15, 1999, for which proxies were solicited pursuant to Regulation 14 under the Securities Exchange Act of 1934, the following matters were voted upon and approved by shareholders.

1. The election of five directors for a term expiring in 2000:

J. Sidney Davenport  
Richard C. Leone  
Thomas H. Potts  
Barry S. Shein  
Donald B. Vaden

2. Approval of the appointment of Deloitte & Touche LLP, independent certified public accountants, as the Company's auditors for the year ended December 31, 1999.

At the Company's special meeting of shareholders held on July 26, 1999, for which proxies were solicited pursuant to Regulation 14 under the Securities Exchange Act of 1934, the following matter was voted upon and approved by shareholder.

1. Approval of an amendment to the Company's Articles of Incorporation to effect a one-for-four split of the issued and outstanding shares of common stock. Total number of votes for and against this matter was 32,634,847 and 3,432,490, respectively. The total number of shares abstained were 673,531.

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

None

(b) Reports on Form 8-K

Current Report on Form 8-K as filed with the Commission on April 2, 1999, relating to the Company's 1998 consolidating financial statements.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DYNEX CAPITAL, INC.

By: /s/ Thomas H. Potts  
Thomas H. Potts, President  
(authorized officer of registrant)

/s/ Lynn K. Geurin  
Lynn K. Geurin, Executive Vice  
President and Chief Financial Officer  
(principal accounting officer)

Dated: August 2, 1999

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