TWO HARBORS INVESTMENT CORP.
Form 10-Q
May 05, 2016

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended: March 31, 2016

Commission File Number 001-34506

TWO HARBORS INVESTMENT CORP.
(Exact Name of Registrant as Specified in Its Charter)

Maryland	27-0312904
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

590 Madison Avenue, 36th Floor New York, New York	10022
(Address of Principal Executive Offices)	(Zip Code)

(612) 629-2500
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x   Accelerated filer o   Non-accelerated filer o   Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.
As of May 4, 2016 there were 347,566,626 shares of outstanding common stock, par value $.01 per share, issued and outstanding.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	March 31, 2016 (unaudited)	December 31, 2015
ASSETS		
Available-for-sale securities, at fair value	$9,584,454	$7,825,320
Residential mortgage loans held-for-sale, at fair value	387,259	811,431
Residential mortgage loans held-for-investment in securitization trusts, at fair value	3,705,647	3,173,727
Commercial real estate assets	744,259	660,953
Mortgage servicing rights, at fair value	446,170	493,688
Cash and cash equivalents	754,827	737,831
Restricted cash	281,145	262,562
Accrued interest receivable	54,517	49,970
Due from counterparties	233,378	17,206
Derivative assets, at fair value	197,847	271,509
Other assets	295,102	271,575
Total Assets (1)	$16,684,605	$14,575,772
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Repurchase agreements	$6,189,852	$5,008,274
Collateralized borrowings in securitization trusts, at fair value	2,809,627	2,000,110
Federal Home Loan Bank advances	4,000,000	3,785,000
Derivative liabilities, at fair value	77,038	7,285
Due to counterparties	91,547	34,294
Dividends payable	79,939	92,016
Other liabilities	65,911	72,232
Total Liabilities (1)	13,313,914	10,999,211
Stockholders' Equity		
Preferred stock, par value $0.01 per share; 50,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, par value $0.01 per share; 900,000,000 shares authorized and 347,562,770 and 353,906,807 shares issued and outstanding, respectively	3,476	3,539
Additional paid-in capital	3,647,236	3,705,519
Accumulated other comprehensive income	380,406	359,061
Cumulative earnings	1,595,825	1,684,755
Cumulative distributions to stockholders	(2,256,252)	(2,176,313)
Total Stockholders' Equity	3,370,691	3,576,561
Total Liabilities and Stockholders' Equity	$16,684,605	$14,575,772

(1) The condensed consolidated balance sheets include assets of consolidated variable interest entities, or VIEs, that can only be used to settle obligations of these VIEs, and liabilities of the consolidated VIEs for which creditors do not have recourse to Two Harbors Investment Corp. At March 31, 2016 and December 31, 2015, assets of the VIEs totaled $3,772,081 and $3,237,918, and liabilities of the VIEs totaled $2,829,662 and $2,017,677, respectively. See Note 3 - Variable Interest Entities for additional information.

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(in thousands, except share data)

	Three Months Ended March 31,	
	2016	2015
Interest income:	(unaudited)	
Available-for-sale securities	$ 79,428	$ 135,525
Trading securities	—	4,695
Residential mortgage loans held-for-sale	7,202	4,271
Residential mortgage loans held-for-investment in securitization trusts	32,771	18,237
Commercial real estate assets	11,072	44
Cash and cash equivalents	290	197
Total interest income	130,763	162,969
Interest expense:		
Repurchase agreements	16,029	20,565
Collateralized borrowings in securitization trusts	19,359	10,708
Federal Home Loan Bank advances	5,972	2,230
Total interest expense	41,360	33,503
Net interest income	89,403	129,466
Other-than-temporary impairments:		
Total other-than-temporary impairment losses	(717)	(127)
Non-credit portion of loss recognized in other comprehensive income (loss)	—	—
Net other-than-temporary credit impairment losses	(717)	(127)
Other income (loss):		
Gain on investment securities	29,474	129,457
Loss on interest rate swap and swaption agreements	(125,484)	(126,443)
Gain on other derivative instruments	16,015	2,967
Gain on residential mortgage loans held-for-sale	10,803	9,092
Servicing income	34,133	32,087
Loss on servicing asset	(101,440)	(52,403)
Other income (loss)	2,827	(1,857)
Total other loss	(133,672)	(7,100)
Expenses:		
Management fees	12,044	12,721
Securitization deal costs	3,732	2,611
Servicing expenses	7,861	6,716
Other operating expenses	14,856	16,055
Total expenses	38,493	38,103
(Loss) income before income taxes	(83,479)	84,136
Provision for (benefit from) income taxes	5,451	(10,657)
Net (loss) income	$ (88,930)	$ 94,793
Basic and diluted (loss) earnings per weighted average common share	$ (0.25)	$ 0.26
Dividends declared per common share	$ 0.23	$ 0.26
Basic and diluted weighted average number of shares of common stock outstanding	349,436,013	366,507,657

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME, continued
(in thousands, except share data)

	Three Months Ended March 31,	
	2016	2015
	(unaudited)	
Comprehensive (loss) income:		
Net (loss) income	$(88,930)	$94,793
Other comprehensive income (loss), net of tax:		
Unrealized gain (loss) on available-for-sale securities	21,345	(5,931)
Other comprehensive income (loss)	21,345	(5,931)
Comprehensive (loss) income	$(67,585)	$88,862

The accompanying notes are an integral part of these condensed consolidated financial statements.

TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share data)

	Common Stock						
	Shares	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Cumulative Earnings	Cumulative Distributions to Stockholders	Total Stockholders' Equity
				(unaudited)			
Balance, December 31, 2014	366,395,920	$3,664	$3,811,027	$ 855,789	$1,195,536	$(1,797,974)	$4,068,042
Cumulative effect of adoption of new accounting principle	—	—	—	—	(2,991)	—	(2,991)
Adjusted balance, January 1, 2015	366,395,920	3,664	3,811,027	855,789	1,192,545	(1,797,974)	4,065,051
Net income	—	—	—	—	94,793	—	94,793
Other comprehensive income before reclassifications, net of tax	—	—	—	93,877	—	—	93,877
Amounts reclassified from accumulated other comprehensive income, net of tax	—	—	—	(99,808)	—	—	(99,808)
Net other comprehensive loss, net of tax	—	—	—	(5,931)	—	—	(5,931)
Issuance of common stock, net of offering costs	19,412	—	200	—	—	—	200
Common dividends declared	—	—	—	—	—	(95,307)	(95,307)
Non-cash equity award compensation	150,801	2	2,687	—	—	—	2,689
Balance, March 31, 2015	366,566,133	$3,666	$3,813,914	$ 849,858	$1,287,338	$(1,893,281)	$4,061,495
Balance, December 31, 2015	353,906,807	$3,539	$3,705,519	$ 359,061	$1,684,755	$(2,176,313)	$3,576,561
Net loss	—	—	—	—	(88,930)	—	(88,930)
Other comprehensive income before reclassifications, net of tax	—	—	—	39,754	—	—	39,754
Amounts reclassified from accumulated other	—	—	—	(18,409)	—	—	(18,409)

comprehensive income, net of tax							
Net other comprehensive income, net of tax	—	—	—	21,345	—	—	21,345
Issuance of common stock, net of offering costs	14,648	—	110	—	—	—	110
Repurchase of common stock	(8,020,000)	(80)	(61,227)	—	—	—	(61,307)
Common dividends declared	—	—	—	—	—	(79,939)	(79,939)
Non-cash equity award compensation	1,661,315	17	2,834	—	—	—	2,851
Balance, March 31, 2016	347,562,770	$3,476	$3,647,236	$ 380,406	$1,595,825	$(2,256,252)	$3,370,691

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Three Months Ended March 31,	
	2016	2015
Cash Flows From Operating Activities:	(unaudited)	
Net (loss) income	$(88,930)	$94,793
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Amortization of premiums and discounts on investment securities and commercial real estate assets, net	5,735	7,554
Other-than-temporary impairment losses	717	127
Realized and unrealized gains on investment securities, net	(29,474)	(129,457)
Gain on residential mortgage loans held-for-sale	(10,803)	(9,092)
(Gain) loss on residential mortgage loans held-for-investment and collateralized borrowings in securitization trusts	(1,484)	2,919
Loss on servicing asset	101,440	52,403
Gain on termination and option expiration of interest rate swaps and swaptions	(30,629)	(11,775)
Unrealized loss on interest rate swaps and swaptions	149,923	110,693
Unrealized gain on other derivative instruments	(4,387)	(4,426)
Equity based compensation	2,851	2,689
Depreciation of fixed assets	328	319
Purchases of residential mortgage loans held-for-sale	(271,448)	(662,064)
Proceeds from sales of residential mortgage loans held-for-sale	19,830	23,831
Proceeds from repayment of residential mortgage loans held-for-sale	36,360	24,947
Net change in assets and liabilities:		
(Increase) decrease in accrued interest receivable	(4,547)	3,013
Decrease (increase) in deferred income taxes, net	7,048	(11,537)
Increase in income taxes receivable	(839)	(293)
(Increase) decrease in prepaid and fixed assets	(87)	25
Decrease in other receivables	208	396
Increase in servicing advances	(7,173)	(3,347)
Increase (decrease) in accrued interest payable	406	(5,353)
Decrease in income taxes payable	(70)	(1,342)
(Decrease) increase in accrued expenses and other liabilities	(6,657)	1,560
Net cash used in operating activities	$(131,682)	$(513,417)

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS, continued
(in thousands)

	Three Months Ended March 31,	
	2016	2015
Cash Flows From Investing Activities:	(unaudited)	
Purchases of available-for-sale securities	$(4,185,685)	$(1,084,742)
Proceeds from sales of available-for-sale securities	2,270,454	900,107
Principal payments on available-for-sale securities	192,171	286,393
Short sales and purchases of other derivative instruments, net	(14,687)	(34,834)
Proceeds from sales of other derivative instruments, net	44,027	23,427
Proceeds from repayment of residential mortgage loans held-for-investment in securitization trusts	133,374	160,853
Purchases of commercial real estate assets	(86,156)	(45,556)
Proceeds from repayment of commercial real estate assets	4,531	—
Purchases of mortgage servicing rights, net of purchase price adjustments	(51,453)	(10,399)
Purchases of Federal Home Loan Bank stock	(11,206)	(10,240)
(Decrease) increase in due to counterparties, net	(158,919)	67,048
Increase in restricted cash	(18,583)	(104,387)
Net cash (used in) provided by investing activities	(1,882,132)	147,670
Cash Flows From Financing Activities:		
Proceeds from repurchase agreements	10,535,094	14,782,724
Principal payments on repurchase agreements	(9,353,516)	(14,620,309)
Proceeds from issuance of collateralized borrowings in securitization trusts	883,633	310,173
Principal payments on collateralized borrowings in securitization trusts	(96,188)	(122,232)
Proceeds from Federal Home Loan Bank advances	215,000	125,000
Proceeds from issuance of common stock, net of offering costs	110	200
Repurchase of common stock	(61,307)	—
Dividends paid on common stock	(92,016)	(95,263)
Net cash provided by financing activities	2,030,810	380,293
Net increase in cash and cash equivalents	16,996	14,546
Cash and cash equivalents at beginning of period	737,831	1,005,792
Cash and cash equivalents at end of period	$754,827	$1,020,338

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS, continued
(in thousands)

	Three Months Ended March 31,	
	2016	2015
Supplemental Disclosure of Cash Flow Information:	(unaudited)	
Cash paid for interest	$23,276	$28,623
Cash (received) paid for taxes	$(689)	$2,511
Noncash Activities:		
Transfers of residential mortgage loans held-for-sale to residential mortgage loans held-for-investment in securitization trusts	$641,738	$589,255
Transfers of residential mortgage loans held-for-sale to other receivables for foreclosed government-guaranteed loans	$5,194	$—
Additions to mortgage servicing rights due to sale of residential mortgage loans held-for-sale	$204	$227
Transfer of fair value of mortgage servicing rights to fair value of Ginnie Mae residential mortgage loans held-for-sale upon buyout	$2,265	$—
Cumulative-effect adjustment to equity for adoption of new accounting principle	$—	$(2,991)
Dividends declared but not paid at end of period	$79,939	$95,307
Reconciliation of residential mortgage loans held-for-sale:		
Residential mortgage loans held-for-sale at beginning of period	$811,431	$535,712
Purchases of residential mortgage loans held-for-sale	271,448	662,064
Transfer of fair value of mortgage servicing rights to fair value of Ginnie Mae residential mortgage loans held-for-sale upon buyout	(2,265)	—
Transfers to residential mortgage loans held-for-investment in securitization trusts	(641,738)	(589,255)
Transfers to other receivables for foreclosed government-guaranteed loans	(5,194)	—
Proceeds from sales of residential mortgage loans held-for-sale	(19,830)	(23,831)
Proceeds from repayment of residential mortgage loans held-for-sale	(36,360)	(24,947)
Realized and unrealized gains on residential mortgage loans held-for-sale	9,767	8,839
Residential mortgage loans held-for-sale at end of period	$387,259	$568,582

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
Notes to the Condensed Consolidated Financial Statements (unaudited)

Note 1. Organization and Operations

Two Harbors Investment Corp., or the Company, is a Maryland corporation focused on investing in, financing and managing residential mortgage-backed securities, or RMBS, residential mortgage loans, mortgage servicing rights, or MSR, commercial real estate and other financial assets. The Company is externally managed and advised by PRCM Advisers LLC, or PRCM Advisers, which is a subsidiary of Pine River Capital Management L.P., or Pine River, a global multi-strategy asset management firm. The Company's common stock is listed on the NYSE under the symbol "TWO".

The Company was incorporated on May 21, 2009, and commenced operations as a publicly traded company on October 28, 2009, upon completion of a merger with Capitol Acquisition Corp., or Capitol, which became a wholly owned indirect subsidiary of the Company as a result of the merger.

The Company has elected to be treated as a real estate investment trust, or REIT, as defined under the Internal Revenue Code of 1986, as amended, or the Code, for U.S. federal income tax purposes. As long as the Company continues to comply with a number of requirements under federal tax law and maintains its qualification as a REIT, the Company generally will not be subject to U.S. federal income taxes to the extent that the Company distributes its taxable income to its stockholders on an annual basis and does not engage in prohibited transactions. However, certain activities that the Company may perform may cause it to earn income which will not be qualifying income for REIT purposes. The Company has designated certain of its subsidiaries as taxable REIT subsidiaries, or TRSs, as defined in the Code, to engage in such activities, and the Company may in the future form additional TRSs.

Note 2. Basis of Presentation and Significant Accounting Policies

Consolidation and Basis of Presentation

The interim unaudited condensed consolidated financial statements of the Company have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission, or SEC. Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles, or U.S. GAAP, have been condensed or omitted according to such SEC rules and regulations. However, management believes that the disclosures included in these interim condensed consolidated financial statements are adequate to make the information presented not misleading. The accompanying condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. In the opinion of management, all normal and recurring adjustments necessary to present fairly the financial condition of the Company at March 31, 2016 and results of operations for all periods presented have been made. The results of operations for the three months ended March 31, 2016 should not be construed as indicative of the results to be expected for future periods or the full year.

The condensed consolidated financial statements of the Company have been prepared on the accrual basis of accounting in accordance with U.S. GAAP. The preparation of financial statements in conformity with U.S. GAAP requires us to make a number of significant estimates and assumptions. These estimates include estimates of fair value of certain assets and liabilities, amount and timing of credit losses, prepayment rates, the period of time during which the Company anticipates an increase in the fair values of real estate securities sufficient to recover unrealized losses in those securities, and other estimates that affect the reported amounts of certain assets and liabilities and disclosure of contingent assets and liabilities as of the date of the condensed consolidated financial statements and the reported amounts of certain revenues and expenses during the reported period. It is likely that changes in these estimates (e.g., valuation changes due to supply and demand, credit performance, prepayments, interest rates, or other reasons) will occur in the near term. The Company's estimates are inherently subjective in nature and actual results could differ from its estimates and the differences may be material.

The condensed consolidated financial statements of the Company include the accounts of all subsidiaries; inter-company accounts and transactions have been eliminated. Certain prior period amounts have been reclassified to conform to the current period presentation. The Company's Chief Investment Officer manages the investment portfolio as a whole and resources are allocated and financial performance is assessed on a consolidated basis.

All trust entities in which the Company holds investments that are considered VIEs for financial reporting purposes were reviewed for consolidation under the applicable consolidation guidance. Whenever the Company has both the power to direct the activities of a trust that most significantly impact the entity's performance, and the obligation to absorb losses or the right to receive benefits of the entity that could be significant, the Company consolidates the trust.

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TWO HARBORS INVESTMENT CORP.
Notes to the Condensed Consolidated Financial Statements (unaudited)

Significant Accounting Policies
Included in Note 2 to the Consolidated Financial Statements of the Company’s 2015 Annual Report on Form 10-K is a summary of the Company’s significant accounting policies. Provided below is a summary of additional accounting policies that are significant to the Company’s consolidated financial condition and results of operations for the three months ended March 31, 2016.
Offsetting Assets and Liabilities
Certain of the Company’s repurchase agreements are governed by underlying agreements that provide for a right of setoff in the event of default of either party to the agreement. The Company also has netting arrangements in place with all derivative counterparties pursuant to standard documentation developed by the International Swap and Derivatives Association, or ISDA, or central clearing exchange agreements, in the case of centrally cleared interest rate swaps. Additionally, the Company and the counterparty or clearing agency are required to post cash collateral based upon the net underlying market value of the Company’s open positions with the counterparty.
Under U.S. GAAP, if the Company has a valid right of setoff, it may offset the related asset and liability and report the net amount. The Company presents repurchase agreements subject to master netting arrangements or similar agreements on a gross basis, and derivative assets and liabilities subject to such arrangements on a net basis, based on derivative type and counterparty, in its condensed consolidated balance sheets. Separately, the Company presents cash collateral subject to such arrangements on a net basis, based on counterparty, in its condensed consolidated balance sheets. However, the Company does not offset financial assets and liabilities with the associated cash collateral on its condensed consolidated balance sheets.
The following tables present information about the Company’s assets and liabilities that are subject to master netting arrangements or similar agreements and can potentially be offset on the Company’s condensed consolidated balance sheets as of March 31, 2016 and December 31, 2015:

	March 31, 2016					
				Gross Amounts Not Offset with Financial Assets (Liabilities) in the Condensed Consolidated Balance Sheets (1)		
(in thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts of Assets (Liabilities) Presented in the Condensed Consolidated Balance Sheets	Financial Instruments	Cash Collateral (Received) Pledged	Net Amount
Assets						
Derivative assets	$311,134	$ (113,287)	$197,847	$(77,038)	$ —	$120,809
Total Assets	$311,134	$ (113,287)	$197,847	$(77,038)	$ —	$120,809
Liabilities						
Repurchase agreements	$(6,189,852)	$ —	$(6,189,852)	$6,189,852	$ —	$—
Derivative liabilities	(190,325)	113,287	(77,038)	77,038	—	—
Total Liabilities	$(6,380,177)	$ 113,287	$(6,266,890)	$6,266,890	$ —	$—

TWO HARBORS INVESTMENT CORP.
Notes to the Condensed Consolidated Financial Statements (unaudited)

December 31, 2015

(in thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts of Assets (Liabilities) Presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset with Financial Assets (Liabilities) in the Condensed Consolidated Balance Sheets (1)		
				Financial Instruments	Cash Collateral (Received) Pledged	Net Amount
Assets						
Derivative assets	$325,755	$ (54,246)	$271,509	$(7,285)	$ —	$264,224
Total Assets	$325,755	$ (54,246)	$271,509	$(7,285)	$ —	$264,224
Liabilities						
Repurchase agreements	$(5,008,274)	$ —	$(5,008,274)	$5,008,274	$ —	$—
Derivative liabilities	(61,531)	54,246	(7,285)	7,285	—	—
Total Liabilities	$(5,069,805)	$ 54,246	$(5,015,559)	$5,015,559	$ —	$—

(1) Amounts presented are limited in total to the net amount of assets or liabilities presented in the condensed consolidated balance sheets by instrument. Excess cash collateral or financial assets that are pledged to counterparties may exceed the financial liabilities subject to a master netting arrangement or similar agreement, or counterparties may have pledged excess cash collateral to the Company that exceed the corresponding financial assets. These excess amounts are excluded from the table above, although separately reported within restricted cash, due from counterparties, or due to counterparties in the Company's condensed consolidated balance sheets.

Recently Issued and/or Adopted Accounting Standards

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board, or FASB, issued ASU No. 2014-09, which is a comprehensive revenue recognition standard that supersedes virtually all existing revenue guidance under U.S. GAAP. The standard's core principle is that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. As a result of the issuance of ASU No. 2015-14 in August 2015 deferring the effective date of ASU No. 2014-09 by one year, the ASU is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2017, with early adoption prohibited. The Company has determined this ASU will not have a material impact on the Company's financial condition or results of operations.

Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern

In August 2014, the FASB issued ASU No. 2014-15, which requires management to evaluate whether there are conditions and events that raise substantial doubt about the entity's ability to continue as a going concern for both annual and interim reporting periods. The update requires certain disclosures if management concludes that substantial doubt exists and plans to alleviate that doubt. The ASU is effective for annual periods ending after December 15, 2016, and for both annual and interim periods thereafter, with early adoption permitted.

Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU No. 2016-01, which changes how entities measure certain equity investments and present changes in the fair value of financial liabilities measured under the fair value option that are attributable to their own credit. The ASU requires certain recurring disclosures and is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2017, with early adoption permitted. The Company has determined this ASU will not have a material impact on the Company’s financial condition or results of operations.

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TWO HARBORS INVESTMENT CORP.
Notes to the Condensed Consolidated Financial Statements (unaudited)

Lease Classification and Accounting

In February 2016, the FASB issued ASU No. 2016-02, which requires lessees to recognize on their balance sheets both a lease liability for the obligation to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. The ASU is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2018, with early adoption permitted. The Company has determined this ASU will not have a material impact on the Company's financial condition or results of operations.

Note 3. Variable Interest Entities

The Company purchases subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or the Company's subsidiaries. Additionally, the Company is the sole certificate holder of a trust entity that holds a commercial real estate loan. All of these trusts are considered VIEs for financial reporting purposes and, thus, were reviewed for consolidation under the applicable consolidation guidance. Because the Company has both the power to direct the activities of the trusts that most significantly impact the entities' performance, and the obligation to absorb losses or the right to receive benefits of the entities that could be significant, the Company consolidates the trusts. As the Company is required to reassess VIE consolidation guidance each quarter, new facts and circumstances may change the Company's determination. A change in the Company's determination could result in a material impact to the Company's condensed consolidated financial statements during subsequent reporting periods.

The following table presents a summary of the assets and liabilities of all consolidated trusts as reported on the condensed consolidated balance sheets as of March 31, 2016 and December 31, 2015:

(in thousands)	March 31, 2016	December 31, 2015
Residential mortgage loans held-for-investment in securitization trusts	$3,705,647	$ 3,173,727
Commercial real estate assets	45,744	45,698
Accrued interest receivable	20,690	18,493
Total Assets	$3,772,081	$ 3,237,918
Collateralized borrowings in securitization trusts	$2,809,627	$ 2,000,110
Accrued interest payable	7,625	5,943
Other liabilities	12,410	11,624
Total Liabilities	$2,829,662	$ 2,017,677

The Company is not required to consolidate VIEs for which it has concluded it does not have both the power to direct the activities of the VIEs that most significantly impact the entities' performance, and the obligation to absorb losses or the right to receive benefits of the entities that could be significant. The Company's investments in these unconsolidated VIEs include non-Agency RMBS, which are classified within available-for-sale securities, at fair value on the consolidated balance sheets. As of March 31, 2016 and December 31, 2015, the carrying value, which also represents the maximum exposure to loss, of all non-Agency RMBS in unconsolidated VIEs was $1.6 billion and $1.9 billion, respectively.

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Note 4. Available-for-Sale Securities, at Fair Value

The Company holds AFS investment securities which are carried at fair value on the condensed consolidated balance sheets. AFS securities exclude the retained interests from the Company’s on-balance sheet securitizations, as they are eliminated in consolidation in accordance with U.S. GAAP. The following table presents the Company’s AFS investment securities by collateral type as of March 31, 2016 and December 31, 2015:

(in thousands)	March 31, 2016	December 31, 2015
Agency		
Federal Home Loan Mortgage Corporation	$1,578,471	$ 1,678,814
Federal National Mortgage Association	6,177,794	3,602,348
Government National Mortgage Association	252,831	691,728
Non-Agency	1,575,358	1,852,430
Total available-for-sale securities	$9,584,454	$ 7,825,320

At March 31, 2016 and December 31, 2015, the Company pledged AFS securities with a carrying value of $9.5 billion and $7.8 billion, respectively, as collateral for repurchase agreements and advances from the Federal Home Loan Bank of Des Moines, or the FHLB. See Note 15 - Repurchase Agreements and Note 17 - Federal Home Loan Bank of Des Moines Advances.

At March 31, 2016 and December 31, 2015, the Company did not have any securities purchased from and financed with the same counterparty that did not meet the conditions of ASC 860, Transfers and Servicing, or ASC 860, to be considered linked transactions and, therefore, classified as derivatives.

The following tables present the amortized cost and carrying value (which approximates fair value) of AFS securities by collateral type as of March 31, 2016 and December 31, 2015:

	March 31, 2016		
(in thousands)	Agency	Non-Agency	Total
Face Value	$10,080,013	$2,345,601	$12,425,614
Unamortized premium	462,545	—	462,545
Unamortized discount			
Designated credit reserve	—	(353,076)	(353,076)
Net, unamortized	(2,649,932)	(679,402)	(3,329,334)
Amortized Cost	7,892,626	1,313,123	9,205,749
Gross unrealized gains	147,958	279,660	427,618
Gross unrealized losses	(31,488)	(17,425)	(48,913)
Carrying Value	$8,009,096	$1,575,358	$9,584,454

	December 31, 2015		
(in thousands)	Agency	Non-Agency	Total
Face Value	$8,257,030	$2,655,381	$10,912,411
Unamortized premium	394,787	—	394,787
Unamortized discount			
Designated credit reserve	—	(409,077)	(409,077)
Net, unamortized	(2,721,979)	(707,021)	(3,429,000)
Amortized Cost	5,929,838	1,539,283	7,469,121
Gross unrealized gains	98,389	329,206	427,595
Gross unrealized losses	(55,337)	(16,059)	(71,396)
Carrying Value	$5,972,890	$1,852,430	$7,825,320

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The following tables present the carrying value of the Company's AFS securities by rate type as of March 31, 2016 and December 31, 2015:

	March 31, 2016		
(in thousands)	Agency	Non-Agency	Total
Adjustable Rate	$36,800	$ 1,391,317	$1,428,117
Fixed Rate	7,972,296	184,041	8,156,337
Total	$8,009,096	$ 1,575,358	$9,584,454

	December 31, 2015		
(in thousands)	Agency	Non-Agency	Total
Adjustable Rate	$108,596	$ 1,673,038	$1,781,634
Fixed Rate	5,864,294	179,392	6,043,686
Total	$5,972,890	$ 1,852,430	$7,825,320

The following table presents the Company's AFS securities according to their estimated weighted average life classifications as of March 31, 2016:

	March 31, 2016		
(in thousands)	Agency	Non-Agency	Total
≤ 1 year	$1,435	$ 79,887	$81,322
> 1 and ≤ 3 years	55,448	53,897	109,345
> 3 and ≤ 5 years	2,609,341	289,683	2,899,024
> 5 and ≤ 10 years	5,337,237	751,508	6,088,745
> 10 years	5,635	400,383	406,018
Total	$8,009,096	$ 1,575,358	$9,584,454

When the Company purchases a credit-sensitive AFS security at a significant discount to its face value, the Company often does not amortize into income a significant portion of this discount that the Company is entitled to earn because the Company does not expect to collect the entire discount due to the inherent credit risk of the security. The Company may also record an other-than-temporary impairment, or OTTI, for a portion of its investment in the security to the extent the Company believes that the amortized cost will exceed the present value of expected future cash flows. The amount of principal that the Company does not amortize into income is designated as a credit reserve on the security, with unamortized net discounts or premiums amortized into income over time to the extent realizable.

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The following table presents the changes for the three months ended March 31, 2016 and 2015, of the unamortized net discount and designated credit reserves on non-Agency AFS securities.

	Three Months Ended March 31,					
	2016			2015		
(in thousands)	Designated Credit Reserve	Unamortized Net Discount	Total	Designated Credit Reserve	Unamortized Net Discount	Total
Beginning balance at January 1	$(409,077)	$(707,021)	$(1,116,098)	$(927,605)	$(967,368)	$(1,894,973)
Acquisitions	1,013	(25,222)	(24,209)	1,183	(935)	248
Accretion of net discount	—	16,760	16,760	—	27,465	27,465
Realized credit losses	3,093	—	3,093	3,727	—	3,727
Reclassification adjustment for other-than-temporary impairments	(121)	—	(121)	1,789	—	1,789
Transfers from (to)	19,454	(19,454)	—	41,092	(41,092)	—
Sales, calls, other	32,562	55,535	88,097	132,430	109,947	242,377
Ending balance at March 31	$(353,076)	$(679,402)	$(1,032,478)	$(747,384)	$(871,983)	$(1,619,367)

The following table presents the components comprising the carrying value of AFS securities not deemed to be other than temporarily impaired by length of time that the securities had an unrealized loss position as of March 31, 2016 and December 31, 2015. At March 31, 2016, the Company held 1,147 AFS securities, of which 65 were in an unrealized loss position for less than twelve consecutive months and 190 were in an unrealized loss position for more than twelve consecutive months. At December 31, 2015, the Company held 1,181 AFS securities, of which 121 were in an unrealized loss position for less than twelve consecutive months and 182 were in an unrealized loss position for more than twelve consecutive months.

	Unrealized Loss Position for					
	Less than 12 Months		12 Months or More		Total	
(in thousands)	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
March 31, 2016	$513,067	$(20,746)	$1,240,930	$(28,167)	$1,753,997	$(48,913)
December 31, 2015	$1,503,939	$(26,984)	$1,141,839	$(44,412)	$2,645,778	$(71,396)

Evaluating AFS Securities for Other-Than-Temporary Impairments

In evaluating AFS securities for OTTI, the Company determines whether there has been a significant adverse quarterly change in the cash flow expectations for a security. The Company compares the amortized cost of each security in an unrealized loss position against the present value of expected future cash flows of the security. The Company also considers whether there has been a significant adverse change in the regulatory and/or economic environment as part of this analysis. If the amortized cost of the security is greater than the present value of expected future cash flows using the original yield as the discount rate, an other-than-temporary credit impairment has occurred. If the Company does not intend to sell and will not be more likely than not required to sell the security, the credit loss is recognized in earnings and the balance of the unrealized loss is recognized in either other comprehensive income (loss), net of tax, or gain on investment securities, depending on the accounting treatment. If the Company intends to sell the security or will be more likely than not required to sell the security, the full unrealized loss is recognized in earnings.

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The Company recorded $0.7 million and $0.1 million in other-than-temporary credit impairments during the three months ended March 31, 2016 and 2015 on three and one non-Agency RMBS, respectively, where the future expected cash flows for each security were less than its amortized cost. As of March 31, 2016, impaired securities with a carrying value of $113.3 million had actual weighted average cumulative losses of 12.3%, weighted average three-month prepayment speed of 4.3%, weighted average 60+ day delinquency of 24.4% of the pool balance, and weighted average FICO score of 671. At March 31, 2016, the Company did not intend to sell the securities and determined that it was not more likely than not that the Company will be required to sell the securities; therefore, only the projected credit loss was recognized in earnings.

The following table presents the changes in OTTI included in earnings for the three months ended March 31, 2016 and 2015:

(in thousands)	Three Months Ended March 31, 2016	2015
Cumulative credit loss at beginning of period	$(6,499)	$(8,241)
Additions:		
Other-than-temporary impairments not previously recognized	(292)	—
Increases related to other-than-temporary impairments on securities with previously recognized other-than-temporary impairments	(425)	(127)
Reductions:		
Decreases related to other-than-temporary impairments on securities paid down	—	—
Decreases related to other-than-temporary impairments on securities sold	596	1,916
Cumulative credit loss at end of period	$(6,620)	$(6,452)

Cumulative credit losses related to OTTI may be reduced for securities sold as well as for securities that mature, are paid down, or are prepaid such that the outstanding principal balance is reduced to zero. Additionally, increases in cash flows expected to be collected over the remaining life of the security cause a reduction in the cumulative credit loss.

Gross Realized Gains and Losses

Gains and losses from the sale of AFS securities are recorded as realized gains (losses) within gain on investment securities in the Company’s condensed consolidated statements of comprehensive (loss) income. For the three months ended March 31, 2016 and 2015, the Company sold AFS securities for $2.3 billion and $0.9 billion with an amortized cost of $2.2 billion and $0.8 billion for net realized gains of $21.7 million and $117.5 million, respectively.

The following table presents the gross realized gains and losses on sales of AFS securities for the three months ended March 31, 2016 and 2015:

(in thousands)	Three Months Ended March 31, 2016	2015
Gross realized gains	$35,194	$117,688
Gross realized losses	(13,493)	(220)
Total realized gains on sales, net	$21,701	$117,468

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Note 5. Residential Mortgage Loans Held-for-Sale, at Fair Value
Residential mortgage loans held-for-sale consists of residential mortgage loans carried at fair value as a result of a fair value option election. The following table presents the carrying value of the Company’s residential mortgage loans held-for-sale as of March 31, 2016 and December 31, 2015:

(in thousands)	March 31, 2016	December 31, 2015
Unpaid principal balance	$390,461	$ 812,661
Fair value adjustment	(3,202)	(1,230)
Carrying value	$387,259	$ 811,431

At March 31, 2016 and December 31, 2015, the Company pledged residential mortgage loans with a carrying value of $323.2 million and $745.5 million, respectively, as collateral for repurchase agreements and FHLB advances. See Note 15 - Repurchase Agreements and Note 17 - Federal Home Loan Bank of Des Moines Advances.

Note 6. Residential Mortgage Loans Held-for-Investment in Securitization Trusts, at Fair Value
The Company purchases subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or the Company’s subsidiaries. The underlying residential mortgage loans held by the trusts, which are consolidated on the Company’s condensed consolidated balance sheets, are classified as residential mortgage loans held-for-investment in securitization trusts and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities for additional information regarding consolidation of the securitization trusts. The following table presents the carrying value of the Company’s residential mortgage loans held-for-investment in securitization trusts as of March 31, 2016 and December 31, 2015:

(in thousands)	March 31, 2016	December 31, 2015
Unpaid principal balance	$3,638,407	$ 3,143,515
Fair value adjustment	67,240	30,212
Carrying value	$3,705,647	$ 3,173,727

Note 7. Commercial Real Estate Assets
The Company originates and purchases commercial real estate debt and related instruments generally to be held as long-term investments. These assets are classified as commercial real estate assets on the condensed consolidated balance sheets. Additionally, the Company is the sole certificate holder of a trust entity that holds a commercial real estate loan. The underlying loan held by the trust is consolidated on the Company’s condensed consolidated balance sheet and classified as commercial real estate assets. See Note 3 - Variable Interest Entities for additional information regarding consolidation of the trust. Commercial real estate assets are reported at cost, net of any unamortized acquisition premiums or discounts, loan fees and origination costs as applicable, unless the assets are deemed impaired.

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The following tables summarize the Company's commercial real estate assets by asset type, property type and geographic location as of March 31, 2016 and December 31, 2015:

(in thousands)	March 31, 2016 Mezzanine Loans	First Mortgages	Total	December 31, 2015 Mezzanine Loans	First Mortgages	Total
Unpaid principal balance	$149,779	$600,502	$750,281	$153,913	$513,433	$667,346
Unamortized (discount) premium	(165)	(198)	(363)	(237)	—	(237)
Unamortized net deferred origination fees	(665)	(4,994)	(5,659)	(830)	(5,326)	(6,156)
Carrying value	$148,949	$595,310	$744,259	$152,846	$508,107	$660,953
Unfunded commitments	$1,900	$64,568	$66,468	$1,900	$50,334	$52,234
Number of loans	6	14	20	6	12	18
Weighted average coupon	8.3 %	4.6 %	5.3 %	8.1 %	4.5 %	5.4 %
Weighted average years to maturity [(1)]	2.3	3.5	3.2	2.6	3.3	3.1

(1) Based on contractual maturity date. Certain loans are subject to contractual extension options which may be subject to conditions as stipulated in the loan agreement. Actual maturities may differ from contractual maturities stated herein as certain borrowers may have the right to prepay with or without paying a prepayment penalty. The Company may also extend contractual maturities in connection with loan modifications.

(in thousands)	March 31, 2016		December 31, 2015	
Property Type	Carrying Value	% of Commercial Portfolio	Carrying Value	% of Commercial Portfolio
Retail	$186,401	25.0 %	$185,883	28.1 %
Hotel	81,502	11.0 %	80,843	12.2 %
Multifamily	165,916	22.3 %	139,011	21.1 %
Office	310,440	41.7 %	255,216	38.6 %
Total	$744,259	100.0 %	$660,953	100.0 %

(in thousands)	March 31, 2016		December 31, 2015	
Geographic Location	Carrying Value	% of Commercial Portfolio	Carrying Value	% of Commercial Portfolio
West	$131,099	17.6 %	$131,488	19.9 %
Southeast	80,443	10.8 %	79,118	12.0 %
Southwest	201,499	27.1 %	161,721	24.4 %
Northeast	264,077	35.5 %	238,913	36.2 %
Midwest	67,141	9.0 %	49,713	7.5 %
Total	$744,259	100.0 %	$660,953	100.0 %

At March 31, 2016 and December 31, 2015, the Company pledged commercial real estate assets with a carrying value of $666.8 million and $361.1 million, respectively, as collateral for repurchase agreements and FHLB advances. See Note 15 - Repurchase Agreements and Note 17 - Federal Home Loan Bank of Des Moines Advances.

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The following table summarizes activity related to commercial real estate assets for the three months ended March 31, 2016 and 2015.

(in thousands)	Three Months Ended March 31, 2016	2015
Balance at beginning of period	$660,953	$—
Originations and purchases	86,870	45,556
Repayments	(4,135)	—
Net discount accretion (premium amortization)	73	—
(Increase) decrease in net deferred origination fees	(1,110)	—
Amortization of net deferred origination fees	1,608	—
Allowance for loan losses	—	—
Balance at end of period	$744,259	$45,556

The Company evaluates each loan for impairment at least quarterly by assessing the risk factors of each loan and assigning a risk rating based on a variety of factors. Risk factors include property type, geographic and local market dynamics, physical condition, leasing and tenant profile, projected cash flow, loan structure and exit plan, loan-to-value ratio, project sponsorship, and other factors deemed necessary. Risk ratings are defined as follows:

1 – Lower Risk
2 – Average Risk
3 – Acceptable Risk
4 – Higher Risk: A loan that has exhibited material deterioration in cash flows and/or other credit factors, which, if negative trends continue, could be indicative of future loss.
5 – Impaired/Loss Likely: A loan that has a significantly increased probability of default or principal loss.

The following table presents the number of loans, unpaid principal balance and carrying value (amortized cost) by risk rating for commercial real estate assets as of March 31, 2016 and December 31, 2015:

(dollars in thousands)	March 31, 2016			December 31, 2015		
Risk Rating	Number of Loans	Unpaid Principal Balance	Carrying Value	Number of Loans	Unpaid Principal Balance	Carrying Value
1 – 3	20	$750,281	$744,259	18	$667,346	$660,953
4 – 5	—	—	—	—	—	—
Total	20	$750,281	$744,259	18	$667,346	$660,953

The Company has not recorded any allowances for losses as no loans are past-due and it is not deemed probable that the Company will not be able to collect all amounts due pursuant to the contractual terms of the loans.

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Note 8. Servicing Activities
Mortgage Servicing Rights, at Fair Value
One of the Company's wholly owned subsidiaries has approvals from Fannie Mae, Freddie Mac, and Ginnie Mae, to own and manage MSR, which represent the right to control the servicing of mortgage loans. The Company and its subsidiaries do not originate or directly service mortgage loans, and instead contract with fully licensed subservicers to handle substantially all servicing functions for the loans underlying the Company's MSR. The following table summarizes activity related to MSR for the three months ended March 31, 2016 and 2015.

	Three Months Ended March 31,	
(in thousands)	2016	2015
Balance at beginning of period	$493,688	$452,006
Additions from purchases of servicing rights	50,273	4,324
Additions from sales of residential mortgage loans	204	227
Changes in fair value due to:		
Changes in valuation inputs or assumptions used in the valuation model	(84,359)	(38,170)
Other changes in fair value [(1)]	(17,081)	(14,233)
Other changes [(2)]	3,445	6,075
Balance at end of period	$446,170	$410,229

(1) Other changes in fair value primarily represents changes due to the realization of expected cash flows.
(2) Other changes includes purchase price adjustments, contractual prepayment protection, and changes due to the Company's purchase of the underlying collateral.

As of March 31, 2016 and December 31, 2015, the key economic assumptions and sensitivity of the fair value of MSR to immediate 10% and 20% adverse changes in these assumptions were as follows:

(in thousands)	March 31, 2016	December 31, 2015
Weighted average prepayment speed:	15.6 %	11.8 %
Impact on fair value of 10% adverse change	$(24,272)	$(20,093)
Impact on fair value of 20% adverse change	$(46,245)	$(38,656)
Weighted average delinquency:	3.3 %	4.0 %
Impact on fair value of 10% adverse change	$(3,034)	$(3,826)
Impact on fair value of 20% adverse change	$(6,001)	$(6,640)
Weighted average discount rate:	9.0 %	10.1 %
Impact on fair value of 10% adverse change	$(11,868)	$(16,316)
Impact on fair value of 20% adverse change	$(23,223)	$(31,522)

These assumptions and sensitivities are hypothetical and should be considered with caution. Changes in fair value based on 10% and 20% variations in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of MSR is calculated without changing any other assumptions. In reality, changes in one factor may result in changes in another (e.g., increased market interest rates may result in lower prepayments and increased credit losses) that could magnify or counteract the sensitivities. Further, these sensitivities show only the change in the asset balances and do not show any expected change in the fair value of the instruments used to manage the interest rates and prepayment risks associated with these assets.

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Risk Mitigation Activities

The primary risk associated with the Company's MSR is interest rate risk and the resulting impact on prepayments. A significant decline in interest rates could lead to higher-than-expected prepayments that could reduce the value of the MSR. The Company economically hedges the impact of these risks with AFS securities and derivative financial instruments. Refer to Note 11 - Derivative Instruments and Hedging Activities for additional information regarding the derivative financial instruments used to economically hedge MSR.

Mortgage Servicing Income

The following table presents the components of servicing income recorded on the Company's condensed consolidated statements of comprehensive (loss) income for the three months ended March 31, 2016 and 2015:

	Three Months Ended March 31,	
(in thousands)	2016	2015
Servicing fee income	$33,109	$31,237
Ancillary fee income	485	564
Float income	539	286
Total	$34,133	$32,087

Mortgage Servicing Advances

In connection with the servicing of loans, the Company's subservicers make certain payments for property taxes and insurance premiums, default and property maintenance payments, as well as advances of principal and interest payments before collecting them from individual borrowers. Servicing advances, including contractual interest, are priority cash flows in the event of a loan principal reduction or foreclosure and ultimate liquidation of the real estate-owned property, thus making their collection reasonably assured. These servicing advances, which are funded by the Company, totaled $44.7 million and $37.5 million and were included in other assets on the condensed consolidated balance sheets as of March 31, 2016 and December 31, 2015, respectively.

Serviced Mortgage Assets

The Company's total serviced mortgage assets consist of loans owned and classified as residential mortgage loans held-for-sale, loans held in consolidated VIEs classified as residential mortgage loans held-for-investment in securitization trusts, and loans underlying MSR. The following table presents the number of loans and unpaid principal balance of the mortgage assets for which the Company manages the servicing as of March 31, 2016 and December 31, 2015:

	March 31, 2016		December 31, 2015	
(dollars in thousands)	Number of Loans	Unpaid Principal Balance	Number of Loans	Unpaid Principal Balance
Residential mortgage loans held-for-sale	994	$390,461	1,415	$812,661
Residential mortgage loans held-for-investment in securitization trusts	402	286,258	413	297,379
Mortgage servicing rights [1]	260,648	55,344,297	245,144	51,386,141
Total serviced mortgage assets	262,044	$56,021,016	246,972	$52,496,181

(1) Includes residential mortgage loans held-for-investment in securitization trusts for which the Company is the named servicing administrator.

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Note 9. Restricted Cash
The Company is required to maintain certain cash balances with counterparties for securities and derivatives trading activity and collateral for the Company's repurchase agreements and FHLB advances in restricted accounts. The Company has also placed cash in a restricted account pursuant to a letter of credit on an office space lease.
The following table presents the Company's restricted cash balances as of March 31, 2016 and December 31, 2015:

(in thousands)	March 31, 2016	December 31, 2015
Restricted cash balances held by trading counterparties:		
For securities and loan trading activity	$ 12,560	$ 12,550
For derivatives trading activity	217,695	130,355
As restricted collateral for repurchase agreements and Federal Home Loan Bank advances	50,543	119,310
Total restricted cash balances held by trading counterparties	280,798	262,215
Restricted cash balance pursuant to letter of credit on office lease	347	347
Total	$ 281,145	$ 262,562

Note 10. Accrued Interest Receivable
The following table presents the Company's accrued interest receivable by collateral type as of March 31, 2016 and December 31, 2015:

(in thousands)	March 31, 2016	December 31, 2015
Available-for-sale securities:		
Agency		
Federal Home Loan Mortgage Corporation	$ 5,894	$ 6,235
Federal National Mortgage Association	19,046	12,407
Government National Mortgage Association	3,181	4,910
Non-Agency	2,189	2,339
Total available-for-sale securities	30,310	25,891
Residential mortgage loans held-for-sale	1,732	4,173
Residential mortgage loans held-for-investment in securitization trusts	20,534	18,339
Commercial real estate assets	1,941	1,567
Total	$ 54,517	$ 49,970

Note 11. Derivative Instruments and Hedging Activities
The Company enters into a variety of derivative and non-derivative instruments in connection with its risk management activities. The Company's primary objective for executing these derivative and non-derivative instruments is to mitigate the Company's economic exposure to future events that are outside its control. The Company's derivative financial instruments are utilized principally to manage market risk and cash flow volatility associated with interest rate risk (including associated prepayment risk) related to certain assets and liabilities. As part of its risk management activities, the Company may, at times, enter into various forward contracts, including short securities, Agency to-be-announced securities, or TBAs, options, futures, swaps, caps, credit default swaps and total return swaps. In executing on the Company's current risk management strategy, the Company has entered into interest rate swap and swaption agreements, TBAs, short U.S. Treasuries, put and call options for TBAs and U.S. Treasuries, constant maturity swaps, credit default swaps and total return swaps (based on the Markit IOS Index). The Company has also entered into a number of non-derivative instruments to manage interest rate risk, principally Agency interest-only securities.

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The following summarizes the Company’s significant asset and liability classes, the risk exposure for these classes, and the Company’s risk management activities used to mitigate certain of these risks. The discussion includes both derivative and non-derivative instruments used as part of these risk management activities. While the Company uses derivative and non-derivative instruments to achieve the Company’s risk management activities, it is possible that these instruments will not effectively mitigate all or a substantial portion of the Company’s market rate risk. In addition, the Company might elect, at times, not to enter into certain hedging arrangements in order to maintain compliance with REIT requirements.

Balance Sheet Presentation

In accordance with ASC 815, Derivatives and Hedging, or ASC 815, the Company records derivative financial instruments on its condensed consolidated balance sheets as assets or liabilities at fair value. Changes in fair value are accounted for depending on the use of the derivative instruments and whether they qualify for hedge accounting treatment. Due to the volatility of the credit markets and difficulty in effectively matching pricing or cash flows, the Company has elected to treat all current derivative contracts as trading instruments.

The following tables present the gross fair value and notional amounts of the Company’s derivative financial instruments treated as trading instruments as of March 31, 2016 and December 31, 2015.

(in thousands)	March 31, 2016			
	Derivative Assets		Derivative Liabilities	
Trading instruments	Fair Value	Notional	Fair Value	Notional
Inverse interest-only securities	$158,786	$882,726	$—	$—
Interest rate swap agreements	18,162	8,865,513	(65,715)	6,560,000
Credit default swaps	—	—	(390)	125,000
Swaptions, net	10,482	3,700,000	(473)	1,500,000
TBAs	9,557	2,187,000	(3,328)	550,000
Put and call options for TBAs, net	366	2,000,000	—	—
Markit IOS total return swaps	—	—	(7,120)	868,145
Forward purchase commitments	494	234,259	(12)	17,953
Total	$197,847	$17,869,498	$(77,038)	$9,621,098

(in thousands)	December 31, 2015			
	Derivative Assets		Derivative Liabilities	
Trading instruments	Fair Value	Notional	Fair Value	Notional
Inverse interest-only securities	$159,582	$932,037	$—	$—
Interest rate swap agreements	91,757	14,268,806	—	—
Credit default swaps	—	—	(703)	125,000
Swaptions, net	17,374	4,700,000	(4,831)	500,000
TBAs	1,074	847,000	(1,324)	550,000
Markit IOS total return swaps	1,645	889,418	—	—
Forward purchase commitments	77	98,736	(427)	187,384
Total	$271,509	$21,735,997	$(7,285)	$1,362,384

Comprehensive (Loss) Income Statement Presentation

The Company has not applied hedge accounting to its current derivative portfolio held to mitigate the interest rate risk and credit risk associated with its portfolio. As a result, the Company is subject to volatility in its earnings due to movement in the unrealized gains and losses associated with its interest rate swaps and its other derivative instruments.

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The following table summarizes the location and amount of gains and losses on derivative instruments reported in the condensed consolidated statements of comprehensive (loss) income on the Company’s derivative trading instruments:

Trading Instruments	Location of Gain (Loss) Recognized in Income on Derivatives	Amount of Gain (Loss) Recognized in Income on Derivatives	
(in thousands)		Three Months Ended March 31,	
		2016	2015
Interest rate risk management			
TBAs [1]	Gain on other derivative instruments	$25,329	$(27,958)
Put and call options for TBAs [1]	Gain on other derivative instruments	(981)	2,535
Constant maturity swaps [1]	Gain on other derivative instruments	—	6,090
Interest rate swap agreements - Receivers [1]	Loss on interest rate swap and swaption agreements	112,674	42,326
Interest rate swap agreements - Payers [1]	Loss on interest rate swap and swaption agreements	(81,084)	(52,559)
Swaptions [1]	Loss on interest rate swap and swaption agreements	(16,255)	(18,506)
Markit IOS total return swaps [1]	Gain on other derivative instruments	(21,724)	3,132
Interest rate swap agreements - Payers [2]	Loss on interest rate swap and swaption agreements	(140,819)	(97,704)
Credit risk management			
Credit default swaps - Receive protection [3]	Gain on other derivative instruments	409	(93)
Non-risk management			
Inverse interest-only securities	Gain on other derivative instruments	12,982	19,261
Forward purchase commitments	Gain on residential mortgage loans held-for-sale	1,398	970
Total		$(108,071)	$(122,506)

(1) Includes derivative instruments held to mitigate interest rate risk associated with the Company’s investment portfolio.
(2) Includes derivative instruments held to mitigate interest rate risk associated with the Company’s repurchase agreements and FHLB advances.
(3) Includes derivative instruments held to mitigate credit risk associated with the Company’s non-Agency RMBS and residential mortgage loans held-for-sale.

For the three months ended March 31, 2016 and 2015, the Company recognized $6.2 million and $27.5 million, respectively, of expenses for the accrual and/or settlement of the net interest expense associated with its interest rate swaps. The expenses result from paying either a fixed interest rate or LIBOR interest on an average $15.0 billion and $18.2 billion notional, respectively, and receiving either LIBOR interest or a fixed interest rate.

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The following tables present information with respect to the volume of activity in the Company's derivative instruments during the three months ended March 31, 2016 and 2015:

	Three Months Ended March 31, 2016					
(in thousands)	Beginning of Period Notional Amount	Additions	Settlement, Termination, Expiration or Exercise	End of Period Notional Amount	Average Notional Amount	Realized Gain (Loss), net [(1)]
Inverse interest-only securities	$932,037	$—	$(49,311)	$882,726	$909,378	$—
Interest rate swap agreements	14,268,806	6,837,513	(5,680,806)	15,425,513	14,954,600	32,599
Credit default swaps	125,000	10,000	(10,000)	125,000	126,429	412
Swaptions, net	5,200,000	2,000,000	(2,000,000)	5,200,000	5,216,484	(1,970)
TBAs, net	297,000	4,315,000	(2,975,000)	1,637,000	153,209	18,850
Put and call options for TBAs, net	—	2,000,000	—	2,000,000	82,418	—
Markit IOS total return swaps	889,418	—	(21,273)	868,145	874,735	—
Forward purchase commitments	286,120	383,449	(417,357)	252,212	257,726	566
Total	$21,998,381	$15,545,962	$(11,153,747)	$26,390,596	$22,574,979	$50,457

	Three Months Ended March 31, 2015					
(in thousands)	Beginning of Period Notional Amount	Additions	Settlement, Termination, Expiration or Exercise	End of Period Notional Amount	Average Notional Amount	Realized Gain (Loss), net [(1)]
Inverse interest-only securities	$1,168,226	$—	$(62,016)	$1,106,210	$1,138,468	$—
Interest rate swap agreements	18,584,000	5,620,000	(4,275,000)	19,929,000	18,238,389	(1,070)
Credit default swaps	125,000	—	—	125,000	125,000	—
Swaptions, net	12,410,000	5,550,000	(5,000,000)	12,960,000	12,851,667	12,845
TBAs, net	(1,325,000)	(6,933,000)	5,762,000	(2,496,000)	2,121,700	(17,364)
Put and call options for TBAs, net	2,000,000	250,000	(4,750,000)	(2,500,000)	8,333	(3,047)
Constant maturity swaps	14,000,000	6,000,000	(17,000,000)	3,000,000	6,988,889	6,384
Markit IOS total return swaps	598,459	676,633	(397,563)	877,529	875,346	4,202
Forward purchase commitments	554,838	1,128,634	(976,168)	707,304	648,343	943
Total	$48,115,523	$12,292,267	$(26,698,747)	$33,709,043	$42,996,135	$2,893

(1) Excludes net interest paid or received in full settlement of the net interest spread liability.

Cash flow activity related to derivative instruments is reflected within the operating activities and investing activities sections of the condensed consolidated statements of cash flows. Derivative fair value adjustments are reflected within the unrealized loss on interest rate swaps and swaptions, unrealized gain on other derivative instruments, and gain on residential mortgage loans held-for-sale line items within the operating activities section of the condensed consolidated statements of cash flows. Realized gains and losses on interest rate swap and swaption agreements are reflected within the gain on termination and option expiration of interest rate swaps and swaptions line item within the operating activities section of the condensed consolidated statements of cash flows. The remaining cash flow activity related to derivative instruments is reflected within the short sales and purchases of other derivative instruments, proceeds from sales of other derivative instruments, net and (decrease) increase in due to counterparties, net line items within the investing activities section of the condensed consolidated statements of cash flows.

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Interest Rate Sensitive Assets/Liabilities
The Company's RMBS investment securities and MSR are generally subject to change in value when mortgage rates decline or increase, depending on the type of investment. Rising mortgage rates generally result in a slowing of refinancing activity, which slows prepayments and results in a decline in the value of the Company's fixed-rate Agency pools and an increase in the value of the Company's MSR. To mitigate the impact of this risk, the Company maintains a portfolio of fixed-rate interest-only securities, which increase in value when interest rates increase, as well as TBA positions, short U.S. Treasuries, put and call options for TBAs and U.S. Treasuries, constant maturity swaps, interest rate swap and swaption agreements and Markit IOS total return swaps to further mitigate its exposure to higher interest rates, decreased prepayment speeds and widening mortgage spreads.
As of March 31, 2016 and December 31, 2015, the Company had outstanding fair value of $39.1 million and $42.9 million, respectively, of interest-only securities in place to economically hedge its investment securities. These interest-only securities are included in AFS securities, at fair value, in the condensed consolidated balance sheets.
The Company is exposed to interest rate risk on residential mortgage loans from the time it commits to purchase a mortgage loan until it acquires the loan from the originator and subsequently sells the loan to a third party. Changes in interest rates impact the market price for the mortgage loans. For example, as market interest rates decline, the value of residential mortgage loans held-for-sale increases, and vice versa. To mitigate the impact of this risk, the Company may enter into derivative contracts to hedge the interest rate risk related to its commitments to purchase residential mortgage loans and residential mortgage loans held-for-sale, such as interest rate swaps, swaptions, TBA positions, short U.S. Treasuries, put and call options for TBAs and U.S. Treasuries and constant maturity swaps.
TBAs. At times, the Company may use TBAs for risk management purposes or as a means of deploying capital until targeted investments are available and to take advantage of temporary displacements in the marketplace. TBAs are forward contracts for the purchase (long notional positions) or sale (short notional positions) of Agency RMBS. The issuer, coupon and stated maturity of the Agency RMBS are predetermined as well as the trade price, face amount and future settle date (published each month by the Securities Industry and Financial Markets Association). However, the specific Agency RMBS to be delivered upon settlement is not known at the time of the TBA transaction. As a result, and because physical delivery of the Agency RMBS upon settlement cannot be assured, the Company accounts for TBAs as derivative instruments.
As of March 31, 2016, $2.2 billion of the Company's long notional TBA positions and $550.0 million of the Company's short notional TBA positions were held in order to economically hedge portfolio risk. As of December 31, 2015, $847.0 million of the Company's long notional TBA positions and $550.0 million of the Company's short notional TBA positions were held in order to economically hedge portfolio risk. The Company discloses these positions on a gross basis according to the unrealized gain or loss position of each TBA contract regardless of long or short notional position. The following tables present the notional amount, cost basis, market value and carrying value (which approximates fair value) of the Company's TBA positions as of March 31, 2016 and December 31, 2015:

	As of March 31, 2016				
				Net Carrying Value (4)	
(in thousands)	Notional Amount (1)	Cost Basis (2)	Market Value (3)	Derivative Assets	Derivative Liabilities
Purchase contracts	$2,187,000	$2,239,170	$2,248,727	$9,557	$ —
Sale contracts	(550,000)	(575,578)	(578,906)	—	(3,328)
TBAs, net	$1,637,000	$1,663,592	$1,669,821	$9,557	$ (3,328)

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	As of December 31, 2015				
				Net Carrying Value (4)	
(in thousands)	Notional Amount (1)	Cost Basis (2)	Market Value (3)	Derivative Assets	Derivative Liabilities
Purchase contracts	$847,000	$858,572	$859,646	$1,074	$—
Sale contracts	(550,000)	(568,813)	(570,137)	—	(1,324)
TBAs, net	$297,000	$289,759	$289,509	$1,074	$ (1,324)

(1) Notional amount represents the face amount of the underlying Agency RMBS.
(2) Cost basis represents the forward price to be paid (received) for the underlying Agency RMBS.
(3) Market value represents the current market value of the TBA (or of the underlying Agency RMBS) as of period-end.
(4) Net carrying value represents the difference between the market value of the TBA as of period-end and its cost basis, and is reported in derivative assets / (liabilities), at fair value, in the condensed consolidated balance sheets.

Put and Call Options for TBAs. As of March 31, 2016, the Company had purchased put options for TBAs with a notional amount of $2.0 billion and paid upfront premiums of approximately $1.3 million. Each of the options expires in May 2016. The put and call options had a net fair market value of $0.4 million included in derivative assets, at fair value, in the condensed consolidated balance sheet as of March 31, 2016.The Company did not hold any put and call options for TBAs as of December 31, 2015.
Interest Rate Swap Agreements. As of March 31, 2016 and December 31, 2015, the Company held the following interest rate swaps in order to mitigate mortgage interest rate exposure (or duration) risk associated with the Company's investment portfolio whereby the Company receives interest at a three-month LIBOR rate:

(notional in thousands)
March 31, 2016

Swaps Maturities	Notional Amounts	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)
2018	$4,165,000	1.298 %	0.638 %	2.32
2020 and Thereafter	1,210,000	2.164 %	0.627 %	4.83
Total	$5,375,000	1.493 %	0.635 %	2.89

(notional in thousands)
December 31, 2015

Swaps Maturities	Notional Amounts	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)
2018	$2,040,000	1.563 %	0.487 %	2.94
2020 and Thereafter	1,210,000	2.164 %	0.531 %	5.08
Total	$3,250,000	1.787 %	0.503 %	3.74

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Additionally, as of March 31, 2016 and December 31, 2015, the Company held the following interest rate swaps in order to mitigate mortgage interest rate exposure (or duration) risk associated with the Company's investment portfolio whereby the Company pays interest at a three-month LIBOR rate:

(notional in thousands)
March 31, 2016

Swaps Maturities	Notional Amounts	Average Pay Rate	Average Fixed Receive Rate	Average Maturity (Years)
2018	$575,000	0.618 %	1.440 %	2.64
2019	500,000	0.621 %	1.042 %	2.81
2020 and Thereafter	2,415,513	0.624 %	1.938 %	6.05
Total	$3,490,513	0.623 %	1.728 %	5.03

(notional in thousands)
December 31, 2015

Swaps Maturities	Notional Amounts	Average Pay Rate	Average Fixed Receive Rate	Average Maturity (Years)
2018	$575,000	0.329 %	1.440 %	2.89
2020 and Thereafter	2,589,000	0.453 %	2.301 %	7.00
Total	$3,164,000	0.431 %	2.145 %	6.26

The Company monitors its borrowings under repurchase agreements and FHLB advances, which are generally floating rate debt, in relation to the rate profile of its investment securities. When it is cost effective to do so, the Company may enter into interest rate swap arrangements to align the interest rate composition of its borrowings under repurchase agreements and FHLB advances with that of its investment securities and debt portfolios. This particularly applies to borrowing agreements with maturities or interest rate resets of less than six months. Typically, the interest receivable terms (i.e., LIBOR) of the interest rate swaps match the terms of the underlying debt, resulting in an effective conversion of the rate of the related repurchase agreement or FHLB advance from floating to fixed.

As of March 31, 2016 and December 31, 2015, the Company had the following outstanding interest rate swaps that were utilized as economic hedges of interest rate exposure (or duration) associated with the Company's short-term repurchase agreements and FHLB advances:

(notional in thousands)
March 31, 2016

Swaps Maturities	Notional Amount	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)
2016	$1,700,000	0.462 %	0.624 %	0.48
2017	2,375,000	0.765 %	0.620 %	1.34
2018	300,000	0.984 %	0.617 %	1.83
2019	350,000	1.283 %	0.623 %	3.19
2020 and Thereafter	1,835,000	1.797 %	0.622 %	7.54
Total	$6,560,000	1.013 %	0.622 %	2.98

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(notional in thousands)
December 31, 2015

Swaps Maturities	Notional Amount	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)
2016	$1,700,000	0.462 %	0.481 %	0.73
2017	2,375,000	0.765 %	0.510 %	1.59
2018	800,000	0.944 %	0.384 %	2.14
2019	350,000	1.283 %	0.340 %	3.44
2020 and Thereafter	2,629,806	1.821 %	0.371 %	8.04
Total	$7,854,806	1.094 %	0.437 %	3.71

Interest Rate Swaptions. As of March 31, 2016 and December 31, 2015, the Company had the following outstanding interest rate swaptions (agreements to enter into interest rate swaps in the future for which the Company would either pay or receive a fixed rate) that were utilized as macro-economic hedges:

	March 31, 2016							
(notional and dollars in thousands)	Option				Underlying Swap			
Swaption	Expiration	Cost	Fair Value	Average Months to Expiration	Notional Amount	Average Pay Rate	Average Receive Rate	Average Term (Years)
Purchase contracts:								
Payer	< 6 Months	$12,025	$3,682	3.71	$1,500,000	3.25 %	3M Libor	10.0
Payer	≥ 6 Months	126,273	7,942	40.35	4,500,000	3.69 %	3M Libor	5.8
Total Payer		$138,298	$11,624	27.51	$6,000,000	3.58 %	3M Libor	6.8
Sale contracts:								
Payer	≥ 6 Months	$(81,248)	$(1,615)	15.02	$(800,000)	3.44 %	3M Libor	10.0
Total Payer		$(81,248)	$(1,615)	15.02	$(800,000)	3.44 %	3M Libor	10.0

	December 31, 2015							
(notional and dollars in thousands)	Option				Underlying Swap			
Swaption	Expiration	Cost	Fair Value	Average Months to Expiration	Notional Amount	Average Fixed Pay Rate	Average Receive Rate	Average Term (Years)
Purchase contracts:								
Payer	< 6 Months	$375	$174	0.75	$2,000,000	2.23 %	3M Libor	6.3
Payer	≥ 6 Months	126,273	19,150	39.17	4,500,000	3.69 %	3M Libor	5.8
Total Payer		$126,648	$19,324	38.51	$6,500,000	3.24 %	3M Libor	5.9

Sale contracts:								
Payer	≥ 6 Months	$(81,248)	$(6,738)	18.01	$(800,000)	3.44 %	3M Libor	10.0
Total Payer		$(81,248)	$(6,738)	18.01	$(800,000)	3.44 %	3M Libor	10.0
Receiver	< 6 Months	$(100)	$(43)	0.73	$(500,000)	3M Libor	1.75 %	10.0
Total Receiver		$(100)	$(43)	0.73	$(500,000)	3M Libor	1.75 %	10.0

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Markit IOS Total Return Swaps. The Company also enters into total return swaps (agreements whereby the Company receives or makes payments based on the total return of an underlying instrument or index, such as the Markit IOS Index, in exchange for fixed or floating rate interest payments) to help mitigate the potential impact of larger increases or decreases in interest rates on the performance of our investment portfolio (referred to as "convexity risk"). Total return swaps based on the Markit IOS Index are intended to synthetically replicate the performance of interest-only securities. The Company had the following total return swap agreements in place at March 31, 2016 and December 31, 2015:

(notional and dollars in thousands)

March 31, 2016

Maturity Date	Current Notional Amount	Fair Value	Upfront Payable	Unrealized Gain (Loss)
January 12, 2043	$(361,370)	$(2,494)	$(866)	$ (3,360)
January 12, 2044	(317,908)	(2,045)	(1,679)	(3,724)
January 12, 2045	(188,867)	(2,581)	1,162	(1,419)
Total	$(868,145)	$(7,120)	$(1,383)	$ (8,503)

(notional and dollars in thousands)

December 31, 2015

Maturity Date	Current Notional Amount	Fair Value	Upfront Payable	Unrealized Gain (Loss)
January 12, 2043	$(369,639)	$456	$(866)	$ (410)
January 12, 2044	(325,003)	350	(1,679)	(1,329)
January 12, 2045	(194,776)	839	1,162	2,001
Total	$(889,418)	$1,645	$(1,383)	$ 262

Credit Risk

The Company's exposure to credit losses on its Agency RMBS portfolio is limited due to implicit or explicit backing from the GSEs. The payment of principal and interest on the Freddie Mac and Fannie Mae mortgage-backed securities are guaranteed by those respective agencies, and the payment of principal and interest on the Ginnie Mae mortgage-backed securities are backed by the full faith and credit of the U.S. Government.

Credit Default Swaps. For non-Agency investment securities, residential mortgage loans and commercial real estate assets, the Company may enter into credit default swaps to hedge credit risk. In future periods, the Company could enhance its credit risk protection, enter into further paired derivative positions, including both long and short credit default swaps, and/or seek opportunistic trades in the event of a market disruption (see discussion under "Non-Risk Management Activities" below). The Company also has processes and controls in place to monitor, analyze, manage and mitigate its credit risk with respect to non-Agency RMBS, residential mortgage loans and commercial real estate assets.

As of March 31, 2016 and December 31, 2015, the Company held credit default swaps through which the Company received credit protection for a fixed premium. The maximum payouts for these credit default swaps are limited to the current notional amounts of each swap contract. Maximum payouts for credit default swaps do not represent the expected future cash requirements, as the Company's credit default swaps are typically liquidated or expire and are not exercised by the holder of the credit default swaps.

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The following tables present credit default swaps through which the Company is receiving protection held as of March 31, 2016 and December 31, 2015:
(notional and dollars in thousands)
March 31, 2016

Protection	Maturity Date	Average Implied Credit Spread	Current Notional Amount	Fair Value	Upfront (Payable) Receivable	Unrealized Gain (Loss)
Receive	June 20, 2016	105.50	$(100,000)	$(249)	$ (260)	$ (509)
	December 20, 2016	496.00	(25,000)	(141)	(4,062)	(4,203)
	Total	183.60	$(125,000)	$(390)	$ (4,322)	$ (4,712)

(notional and dollars in thousands)
December 31, 2015

Protection	Maturity Date	Average Implied Credit Spread	Current Notional Amount	Fair Value	Upfront (Payable) Receivable	Unrealized Gain (Loss)
Receive	June 20, 2016	105.50	$(100,000)	$(502)	$ (260)	$ (762)
	December 20, 2016	496.00	(25,000)	(201)	(4,062)	(4,263)
	Total	183.60	$(125,000)	$(703)	$ (4,322)	$ (5,025)

Derivative financial instruments contain an element of credit risk if counterparties are unable to meet the terms of the agreements. Credit risk associated with derivative financial instruments is measured as the net replacement cost should the counterparties that owe the Company under such contracts completely fail to perform under the terms of these contracts, assuming there are no recoveries of underlying collateral, as measured by the market value of the derivative financial instruments. As of March 31, 2016, the fair value of derivative financial instruments as an asset and liability position was $197.8 million and $77.0 million, respectively.
The Company attempts to mitigate its credit risk exposure on derivative financial instruments by limiting its counterparties to banks and financial institutions that meet established credit guidelines. The Company also seeks to spread its credit risk exposure across multiple counterparties in order to reduce its exposure to any single counterparty. Additionally, the Company reduces credit risk on the majority of its derivative instruments by entering into agreements that permit the closeout and netting of transactions with the same counterparty or clearing agency, in the case of centrally cleared interest rate swaps, upon the occurrence of certain events. To further mitigate the risk of counterparty default, the Company maintains collateral agreements with certain of its counterparties and clearing agencies, which require both parties to maintain cash deposits in the event the fair values of the derivative financial instruments exceed established thresholds. As of March 31, 2016, the Company had received cash deposits from counterparties of $2.2 million and placed cash deposits of $232.1 million in accounts maintained by counterparties, of which the amounts are netted on a counterparty basis and classified within restricted cash, due from counterparties, or due to counterparties on the Company’s condensed consolidated balance sheets.
Non-Risk Management Activities
The Company has entered into certain financial instruments that are considered derivative contracts under ASC 815 that are not for purposes of hedging. These contracts are currently limited to forward purchase commitments and inverse interest-only RMBS.

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Commitments to Purchase Residential Mortgage Loans Held-for-Sale. Prior to a mortgage loan purchase, the Company may enter into forward purchase commitments with counterparties whereby the Company commits to purchasing the loans at a particular interest rate, provided the borrower elects to close the loan. These commitments to purchase mortgage loans have been defined as derivatives and are, therefore, recorded on the Company's condensed consolidated balance sheets as assets or liabilities and measured at fair value. Subsequent changes in fair value are recorded on the Company's condensed consolidated balance sheets as adjustments to the carrying value of these assets or liabilities with a corresponding adjustment recognized in current period earnings. As of March 31, 2016 and December 31, 2015, the Company had outstanding commitments to purchase $252.2 million and $286.1 million of mortgage loans, subject to fallout if the loans do not close, with a fair value asset of $0.5 million and a fair value liability of $12,492 at March 31, 2016 and a fair value asset of $0.1 million and a fair value liability of $0.4 million at December 31, 2015, respectively.

Inverse Interest-Only Securities. As of March 31, 2016 and December 31, 2015, inverse interest-only securities with a carrying value of $158.8 million and $159.6 million, including accrued interest receivable of $1.6 million and $1.7 million, respectively, are accounted for as derivative financial instruments in the condensed consolidated financial statements. The following table presents the amortized cost and carrying value (which approximates fair value) of inverse interest-only securities as of March 31, 2016 and December 31, 2015:

(in thousands)	March 31, 2016	December 31, 2015
Face Value	$882,726	$ 932,037
Unamortized premium	—	—
Unamortized discount		
Designated credit reserve	—	—
Net, unamortized	(750,622)	(792,178)
Amortized Cost	132,104	139,859
Gross unrealized gains	25,538	19,655
Gross unrealized losses	(423)	(1,608)
Carrying Value	$157,219	$ 157,906

Note 12. Other Assets

Other assets as of March 31, 2016 and December 31, 2015 are summarized in the following table:

(in thousands)	March 31, 2016	December 31, 2015
Property and equipment at cost	$6,289	$ 5,997
Accumulated depreciation [(1)]	(3,611)	(3,303)
Net property and equipment	2,678	2,694
Prepaid expenses	1,347	1,572
Income taxes receivable	6,125	5,286
Deferred tax assets, net	43,882	44,318
Servicing advances	44,672	37,499
Federal Home Loan Bank stock	167,856	156,650
Equity investments	3,000	3,000
Other receivables	25,542	20,556
Total other assets	$295,102	$ 271,575

(1) Depreciation expense for the three months ended March 31, 2016 was $0.3 million.

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Note 13. Other Liabilities
Other liabilities as of March 31, 2016 and December 31, 2015 are summarized in the following table:

(in thousands)	March 31, 2016	December 31, 2015
Accrued expenses	$ 29,972	$ 37,052
Accrued interest payable	19,129	18,723
Income taxes payable	—	70
Other	16,810	16,387
Total other liabilities	$ 65,911	$ 72,232

Note 14. Fair Value
Fair Value Measurements
ASC 820, Fair Value Measurements and Disclosures, or ASC 820, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices available in active markets (i.e., observable inputs) and the lowest priority to data lacking transparency (i.e., unobservable inputs). Additionally, ASC 820 requires an entity to consider all aspects of nonperformance risk, including the entity's own credit standing, when measuring fair value of a liability.
ASC 820 establishes a three-level hierarchy to be used when measuring and disclosing fair value. An instrument's categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation. Following is a description of the three levels:

Level 1	Inputs are quoted prices in active markets for identical assets or liabilities as of the measurement date under current market conditions. Additionally, the entity must have the ability to access the active market and the quoted prices cannot be adjusted by the entity.
Level 2	Inputs include quoted prices in active markets for similar assets or liabilities; quoted prices in inactive markets for identical or similar assets or liabilities; or inputs that are observable or can be corroborated by observable market data by correlation or other means for substantially the full-term of the assets or liabilities.
Level 3	Unobservable inputs are supported by little or no market activity. The unobservable inputs represent the assumptions that market participants would use to price the assets and liabilities, including risk. Generally, Level 3 assets and liabilities are valued using pricing models, discounted cash flow methodologies, or similar techniques that require significant judgment or estimation.

Following are descriptions of the valuation methodologies used to measure material assets and liabilities at fair value and details of the valuation models, key inputs to those models and significant assumptions utilized.
Available-for-sale securities. The Company holds a portfolio of AFS securities that are carried at fair value in the condensed consolidated balance sheets and primarily comprised of Agency and non-Agency RMBS. The Company determines the fair value of its Agency RMBS based upon prices obtained from third-party pricing providers or broker quotes received using bid price, which are deemed indicative of market activity. The third-party pricing providers and brokers use pricing models that generally incorporate such factors as coupons, primary and secondary mortgage rates, rate reset period, issuer, prepayment speeds, credit enhancements and expected life of the security. In determining the fair value of its non-Agency RMBS, management judgment may be used to arrive at fair value that considers prices obtained from third-party pricing providers, broker quotes received and other applicable market data. If observable market prices are not available or insufficient to determine fair value due principally to illiquidity in the marketplace,

then fair value is based upon internally developed models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels, and credit losses). The Company classified 100% of its RMBS AFS securities reported at fair value as Level 2 at March 31, 2016. AFS securities account for 66.9% of all assets reported at fair value at March 31, 2016.

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Residential mortgage loans held-for-sale. The Company holds residential mortgage loans held-for-sale that are carried at fair value in the condensed consolidated balance sheets as a result of a fair value option election. The Company determines fair value of its residential mortgage loans based on prices obtained from third-party pricing providers and other applicable market data. If observable market prices are not available or insufficient to determine fair value due principally to illiquidity in the marketplace, then fair value is based upon cash flow models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels and credit losses). The Company classified 81.3% and 18.7% of its residential mortgage loans held-for-sale as Level 2 and Level 3 fair value assets, respectively, at March 31, 2016.

Residential mortgage loans held-for-investment in securitization trusts. The Company recognizes on its condensed consolidated balance sheets residential mortgage loans held-for-investment in securitization trusts that are carried at fair value as a result of a fair value option election. An entity is allowed to measure both the financial assets and financial liabilities of a qualifying CFE it consolidates using the fair value of either the CFE's financial assets or financial liabilities, whichever is more observable. As the Company's securitization trusts are considered qualifying CFEs, the Company determines the fair value of these residential mortgage loans based on the fair value of its collateralized borrowings in securitization trusts and its retained interests from the Company's on-balance sheet securitizations (eliminated in consolidation in accordance with U.S. GAAP), as the fair value of these instruments is more observable. The Company classified 100% of its residential mortgage loans held-for-investment in securitization trusts as Level 2 fair value assets at March 31, 2016.

Mortgage servicing rights. The Company holds a portfolio of MSR that are carried at fair value on the condensed consolidated balance sheets. The Company determines fair value of its MSR based on prices obtained from third-party pricing providers. Although MSR transactions are observable in the marketplace, the valuation is based upon cash flow models that include unobservable market data inputs (including prepayment speeds, delinquency levels and discount rates). As a result, the Company classified 100% of its MSR as Level 3 fair value assets at March 31, 2016.

Derivative instruments. The Company may enter into a variety of derivative financial instruments as part of its hedging strategies. The Company principally executes over-the-counter, or OTC, derivative contracts, such as interest rate swaps, swaptions, put and call options for TBAs and U.S. Treasuries, credit default swaps, constant maturity swaps and Markit IOS total return swaps. The Company utilizes third-party pricing providers to value its financial derivative instruments. The Company classified 100% of the interest rate swaps, swaptions, put and call options for TBAs and U.S. Treasuries, credit default swaps, constant maturity swaps and total returns swaps reported at fair value as Level 2 at March 31, 2016.

The Company also enters into certain other derivative financial instruments, such as TBAs, short U.S. Treasuries and inverse interest-only securities. These instruments are similar in form to the Company's AFS securities and the Company utilizes a pricing service to value TBAs and broker quotes to value short U.S. Treasuries and inverse interest-only securities. The Company classified 100% of its inverse interest-only securities at fair value as Level 2 at March 31, 2016. The Company reported 100% of its TBAs as Level 1 as of March 31, 2016. The Company did not hold any short U.S. Treasuries at March 31, 2016.

The Company may also enter into forward purchase commitments on residential mortgage loans whereby the Company commits to purchasing the loans at a particular interest rate. The fair value of these derivatives is determined based on prices currently offered in the marketplace for new commitments. Fallout assumptions if the borrower elects not to close the loan are applied to the pricing. As of March 31, 2016, the Company had outstanding commitments to purchase $252.2 million of mortgage loans, subject to fallout if the loans do not close, with a fair value asset of $0.5 million and a fair value liability of $12,492. The Company classified 100% of the forward purchase commitments reported at fair value as Level 2 at March 31, 2016.

The Company's risk management committee governs trading activity relating to derivative instruments. The Company's policy is to minimize credit exposure related to financial derivatives used for hedging by limiting the hedge counterparties to major banks, financial institutions, exchanges, and private investors who meet established capital and credit guidelines as well as by limiting the amount of exposure to any individual counterparty.

The Company has netting arrangements in place with all derivative counterparties pursuant to standard documentation developed by ISDA, or central clearing exchange agreements, in the case of centrally cleared interest rate swaps. Additionally, both the Company and the counterparty or clearing agency are required to post cash collateral based upon the net underlying market value of the Company’s open positions with the counterparty. Posting of cash collateral typically occurs daily, subject to certain dollar thresholds. Due to the existence of netting arrangements, as well as frequent cash collateral posting at low posting thresholds, credit exposure to the Company and/or to the counterparty or clearing agency is considered materially mitigated. Based on the Company’s assessment, there is no requirement for any additional adjustment to derivative valuations specifically for credit.

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Collateralized borrowings in securitization trusts. The Company recognizes on its condensed consolidated balance sheets collateralized borrowings that are carried at fair value as a result of a fair value option election. In determining the fair value of its collateralized borrowings, management judgment may be used to arrive at fair value that considers prices obtained from third-party pricing providers, broker quotes received and other applicable market data. If observable market prices are not available or insufficient to determine fair value due principally to illiquidity in the marketplace, then fair value is based upon internally developed models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels, and credit losses). The Company classified 100% of its collateralized borrowings in securitization trusts as Level 2 fair value liabilities at March 31, 2016.
The following tables display the Company’s assets and liabilities measured at fair value on a recurring basis. The Company often economically hedges the fair value change of its assets or liabilities with derivatives and other financial instruments. The tables below display the hedges separately from the hedged items, and therefore do not directly display the impact of the Company’s risk management activities.

	Recurring Fair Value Measurements At March 31, 2016			
(in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale securities	$—	$9,584,454	$—	$9,584,454
Residential mortgage loans held-for-sale	—	314,962	72,297	387,259
Residential mortgage loans held-for-investment in securitization trusts	—	3,705,647	—	3,705,647
Mortgage servicing rights	—	—	446,170	446,170
Derivative assets	9,557	188,290	—	197,847
Total assets	$9,557	$13,793,353	$518,467	$14,321,377
Liabilities				
Collateralized borrowings in securitization trusts	$—	$2,809,627	$—	$2,809,627
Derivative liabilities	3,328	73,710	—	77,038
Total liabilities	$3,328	$2,883,337	$—	$2,886,665

	Recurring Fair Value Measurements At December 31, 2015			
(in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale securities	$—	$7,825,320	$—	$7,825,320
Residential mortgage loans held-for-sale	—	764,319	47,112	811,431
Residential mortgage loans held-for-investment in securitization trusts	—	3,173,727	—	3,173,727
Mortgage servicing rights	—	—	493,688	493,688
Derivative assets	1,074	270,435	—	271,509
Total assets	$1,074	$12,033,801	$540,800	$12,575,675
Liabilities				
Collateralized borrowings in securitization trusts	$—	$2,000,110	$—	$2,000,110
Derivative liabilities	1,324	5,961	—	7,285
Total liabilities	$1,324	$2,006,071	$—	$2,007,395

The Company may be required to measure certain assets or liabilities at fair value from time to time. These periodic fair value measures typically result from application of certain impairment measures under U.S. GAAP. These items would constitute nonrecurring fair value measures under ASC 820. As of March 31, 2016, the Company did not have any assets or liabilities measured at fair value on a nonrecurring basis in the periods presented.

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The valuation of Level 3 instruments requires significant judgment by the third-party pricing providers and/or management. The third-party pricing providers and/or management rely on inputs such as market price quotations from market makers (either market or indicative levels), original transaction price, recent transactions in the same or similar instruments, and changes in financial ratios or cash flows to determine fair value. Level 3 instruments may also be discounted to reflect illiquidity and/or non-transferability, with the amount of such discount estimated by the third-party pricing provider in the absence of market information. Assumptions used by the third-party pricing provider due to lack of observable inputs may significantly impact the resulting fair value and therefore the Company's condensed consolidated financial statements. The Company's valuation committee reviews all valuations that are based on pricing information received from a third-party pricing provider. As part of this review, prices are compared against other pricing or input data points in the marketplace, along with internal valuation expertise, to ensure the pricing is reasonable. In addition, the Company performs back-testing of pricing information to validate price information and identify any pricing trends of a third-party price provider.

In determining fair value, third-party pricing providers use various valuation approaches, including market and income approaches. Inputs that are used in determining fair value of an instrument may include pricing information, credit data, volatility statistics, and other factors. In addition, inputs can be either observable or unobservable.

The availability of observable inputs can vary by instrument and is affected by a wide variety of factors, including the type of instrument, whether the instrument is new and not yet established in the marketplace and other characteristics particular to the instrument. The third-party pricing provider uses prices and inputs that are current as of the measurement date, including during periods of market dislocations. In periods of market dislocation, the availability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified to or from various levels within the fair value hierarchy.

Securities for which market quotations are readily available are valued at the bid price (in the case of long positions) or the ask price (in the case of short positions) at the close of trading on the date as of which value is determined. Exchange-traded securities for which no bid or ask price is available are valued at the last traded price. OTC derivative contracts, including interest rate swaps, swaptions, credit default swaps and Markit IOS total return swaps, are valued by the Company using observable inputs, specifically quotations received from third-party pricing providers, and are therefore classified within Level 2.

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The following table presents the reconciliation for all of the Company’s Level 3 assets measured at fair value on a recurring basis:

	Level 3 Recurring Fair Value Measurements Three Months Ended March 31, 2016	
(in thousands)	Residential Mortgage Loans Held-For-Sale	Mortgage Servicing Rights
Beginning of period level 3 fair value	$47,112	$493,688
Gains (losses) included in net (loss) income:		
Realized gains (losses)	1,222	(17,081)
Unrealized gains (losses)	(1,296) (1)	(84,359) (3)
Total gains (losses) included in net (loss) income	(74)	(101,440)
Other comprehensive income (loss)	—	—
Purchases	71,566	50,477
Sales	(20,065)	—
Settlements	(26,242)	3,445
Gross transfers into level 3	—	—
Gross transfers out of level 3	—	—
End of period level 3 fair value	$72,297	$446,170
Change in unrealized gains or losses for the period included in earnings for assets held at the end of the reporting period	$(311) (2)	$(84,359) (4)

(1) The change in unrealized gains or losses on residential mortgage loans held-for-sale was recorded in gain on residential mortgage loans held-for-sale on the condensed consolidated statements of comprehensive (loss) income.

(2) The change in unrealized gains or losses on residential mortgage loans held-for-sale that were held at the end of the reporting period was recorded in gain on residential mortgage loans held-for-sale on the condensed consolidated statements of comprehensive (loss) income.

(3) The change in unrealized gains or losses on MSR was recorded in loss on servicing asset on the condensed consolidated statements of comprehensive (loss) income.

(4) The change in unrealized gains or losses on MSR that were held at the end of the reporting period was recorded in loss on servicing asset on the condensed consolidated statements of comprehensive (loss) income.

The Company did not incur transfers between Level 1, Level 2 or Level 3 during the three months ended March 31, 2016. Transfers between Levels are deemed to take place on the first day of the reporting period in which the transfer has taken place.
The Company used a third-party pricing provider in the fair value measurement of its Level 3 residential mortgage loans held-for-sale. The significant unobservable inputs used by the third-party pricing provider included expected default, severity and discount rate. Significant increases (decreases) in any of the inputs in isolation may result in significantly lower (higher) fair value measurement.

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The Company also used a third-party pricing provider in the fair value measurement of its Level 3 MSR. The table below presents information about the significant unobservable inputs used by the third-party pricing provider in the fair value measurement of the Company's MSR classified as Level 3 fair value assets at March 31, 2016:

As of March 31, 2016

Valuation Technique	Unobservable Input [1]	Range	Weighted Average
Discounted cash flow	Constant prepayment speed	12.2 - 18.3 %	15.6%
	Delinquency	3.1 - 3.5 %	3.3%
	Discount rate	8.1 - 9.8 %	9.0%

(1) Significant increases (decreases) in any of the inputs in isolation may result in significantly lower (higher) fair value measurement. A change in the assumption used for discount rates may be accompanied by a directionally similar change in the assumption used for the probability of delinquency and a directionally opposite change in the assumption used for prepayment rates.

Fair Value Option for Financial Assets and Financial Liabilities

On July 1, 2015, the Company elected the fair value option for Agency interest-only securities and GSE credit risk transfer securities acquired on or after such date. The fair value option was elected to simplify the reporting of changes in fair value. Agency interest-only securities and GSE credit risk transfer securities are carried within AFS securities on the condensed consolidated balance sheets. The Company's policy is to separately record interest income, net of premium amortization or including discount accretion, on these fair value elected securities. Fair value adjustments are reported in gain on investment securities on the condensed consolidated statements of comprehensive (loss) income.

The Company elected the fair value option for the residential mortgage loans it has acquired. The fair value option was elected to mitigate earnings volatility by better matching the accounting for the assets with the related hedges. The mortgage loans are carried within residential mortgage loans held-for-sale on the condensed consolidated balance sheets. The Company's policy is to separately record interest income on these fair value elected loans. Upfront fees and costs related to the fair value elected loans are not deferred or capitalized. Fair value adjustments are reported in gain on residential mortgage loans held-for-sale on the condensed consolidated statements of comprehensive (loss) income. The fair value option is irrevocable once the loan is acquired.

The Company also elected the fair value option for both the residential mortgage loans held-for-investment in securitization trusts and the collateralized borrowings in securitization trusts carried on the condensed consolidated balance sheets. The fair value option was elected to better reflect the economics of the Company's retained interests. The Company's policy is to separately record interest income on the fair value elected loans and interest expense on the fair value elected borrowings. Upfront fees and costs are not deferred or capitalized. Fair value adjustments are reported in other income (loss) on the condensed consolidated statements of comprehensive (loss) income.

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The following tables summarize the fair value option elections and information regarding the line items and amounts recognized in the condensed consolidated statements of comprehensive (loss) income for each fair value option-elected item.

	Three Months Ended March 31, 2016					
(in thousands)	Interest income (expense)	Gain on investment securities	Gain on residential mortgage loans held-for-sale	Other income (loss)	Total included in net (loss) income	Change in fair value due to credit risk
Assets						
Available-for-sale securities	$1	$ 16	$ —	$—	$17	N/A
Residential mortgage loans held-for-sale	7,202 (1)	—	9,971	—	17,173	$110 (2)
Residential mortgage loans held-for-investment in securitization trusts	32,771 (1)	—	—	23,555	56,326	— (3)
Liabilities						
Collateralized borrowings in securitization trusts	(19,359)	—	—	(22,072)	(41,431)	— (3)
Total	$20,615	$ 16	$ 9,971	$1,483	$32,085	$110

	Three Months Ended March 31, 2015					
(in thousands)	Interest income (expense)	Gain on investment securities	Gain on residential mortgage loans held-for-sale	Other income (loss)	Total included in net (loss) income	Change in fair value due to credit risk
Assets						
Available-for-sale securities	$—	$ —	$ —	$—	$—	N/A
Residential mortgage loans held-for-sale	4,271 (1)	—	9,066	—	13,337	$(242) (2)
Residential mortgage loans held-for-investment in securitization trusts	18,236 (1)	—	—	49	18,285	— (3)
Liabilities						
Collateralized borrowings in securitization trusts	(10,708)	—	—	(2,967)	(13,675)	— (3)
Total	$11,799	$ —	$ 9,066	$(2,918)	$17,947	$(242)

(1) Interest income on residential mortgage loans held-for-sale and residential mortgage loans held-for-investment in securitization trusts is measured by multiplying the unpaid principal balance on the loans by the coupon rate and the number of days of interest due.

(2) The change in fair value due to credit risk on residential mortgage loans held-for-sale was quantified by holding yield constant in the cash flow model in order to isolate credit risk component.

(3) The change in fair value on residential mortgage loans held-for-investment in securitization trusts and collateralized borrowings in securitization trusts was due entirely to changes in market interest rates.

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The table below provides the fair value and the unpaid principal balance for the Company's fair value option-elected loans and collateralized borrowings.

	March 31, 2016		December 31, 2015	
(in thousands)	Unpaid Principal Balance	Fair Value (1)	Unpaid Principal Balance	Fair Value (1)
Residential mortgage loans held-for-sale				
Total loans	$390,461	$387,259	$812,661	$811,431
Nonaccrual loans	$54,991	$48,358	$30,438	$25,771
Loans 90+ days past due	$50,628	$44,784	$26,702	$22,470
Residential mortgage loans held-for-investment in securitization trusts				
Total loans	$3,638,407	$3,705,647	$3,143,515	$3,173,727
Nonaccrual loans	$860	$877	$860	$868
Loans 90+ days past due	$860	$877	$860	$868
Collateralized borrowings in securitization trusts				
Total borrowings	$2,804,575	$2,809,627	$2,023,239	$2,000,110

(1) Excludes accrued interest receivable.

Fair Value of Financial Instruments

In accordance with ASC 820, the Company is required to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized in the condensed consolidated balance sheets, for which fair value can be estimated.

The following describes the Company's methods for estimating the fair value for financial instruments. Descriptions are not provided for those items that have zero balances as of the current balance sheet date.

- AFS securities, residential mortgage loans held-for-sale, residential mortgage loans held-for-investment in securitization trusts, MSR, derivative assets and liabilities, and collateralized borrowings in securitization trusts are recurring fair value measurements; carrying value equals fair value. See discussion of valuation methods and assumptions within the Fair Value Measurements section of this Note 14.
- Commercial real estate assets are carried at cost, net of any unamortized acquisition premiums or discounts, loan fees and origination costs as applicable, unless deemed impaired. Because the Company has not yet recorded any allowances for losses and the rates and terms of the commercial real estate assets held at March 31, 2016 are similar to those observed in the market, carrying value, or amortized cost, approximates fair value. The Company categorizes the fair value measurement of these assets as Level 3.
- Cash and cash equivalents and restricted cash have a carrying value which approximates fair value because of the short maturities of these instruments. The Company categorizes the fair value measurement of these assets as Level 1.
- As a condition to membership in the FHLB, the Company is required to purchase and hold a certain amount of FHLB stock, which is considered a non-marketable, long-term investment, and is carried at cost. Because this stock can only be redeemed or sold at its par value, and only to the FHLB, carrying value, or cost, approximates fair value. The Company categorizes the fair value measurement of these assets as Level 3.
- Equity investments include cost method investments for which fair value is not estimated. Carrying value, or cost, approximates fair value. The Company categorizes the fair value measurement of these assets as Level 3.
- The carrying value of repurchase agreements and FHLB advances that mature in less than one year generally approximates fair value due to the short maturities. As of March 31, 2016, the Company held $102.4 million of repurchase agreements and $3.6 billion of FHLB advances that are considered long-term. The Company's long-term

repurchase agreements and FHLB advances have floating rates based on an index plus a spread and, for members of the FHLB, the credit spread is typically consistent with those demanded in the market. Accordingly, the interest rates on these borrowings are at market and thus carrying value approximates fair value. The Company categorizes the fair value measurement of these liabilities as Level 2.

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The following table presents the carrying values and estimated fair values of assets and liabilities that are required to be recorded or disclosed at fair value at March 31, 2016 and December 31, 2015.

	March 31, 2016		December 31, 2015	
(in thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Available-for-sale securities	$9,584,454	$9,584,454	$7,825,320	$7,825,320
Residential mortgage loans held-for-sale	$387,259	$387,259	$811,431	$811,431
Residential mortgage loans held-for-investment in securitization trusts	$3,705,647	$3,705,647	$3,173,727	$3,173,727
Commercial real estate assets	$744,259	$744,259	$660,953	$660,953
Mortgage servicing rights	$446,170	$446,170	$493,688	$493,688
Cash and cash equivalents	$754,827	$754,827	$737,831	$737,831
Restricted cash	$281,145	$281,145	$262,562	$262,562
Derivative assets	$197,847	$197,847	$271,509	$271,509
Federal Home Loan Bank stock	$167,856	$167,856	$156,650	$156,650
Equity investments	$3,000	$3,000	$3,000	$3,000
Liabilities				
Repurchase agreements	$6,189,852	$6,189,852	$5,008,274	$5,008,274
Collateralized borrowings in securitization trusts	$2,809,627	$2,809,627	$2,000,110	$2,000,110
Federal Home Loan Bank advances	$4,000,000	$4,000,000	$3,785,000	$3,785,000
Derivative liabilities	$77,038	$77,038	$7,285	$7,285

Note 15. Repurchase Agreements

As of March 31, 2016 and December 31, 2015, the Company had outstanding $6.2 billion and $5.0 billion, respectively, of repurchase agreements. Excluding the effect of the Company's interest rate swaps, the repurchase agreements had a weighted average borrowing rate of 1.15% and 1.10% and weighted average remaining maturities of 62 and 35 days as of March 31, 2016 and December 31, 2015, respectively.

At March 31, 2016 and December 31, 2015, the repurchase agreement balances were as follows:

(in thousands)	March 31, 2016	December 31, 2015
Short-term	$6,087,417	$ 5,008,274
Long-term	102,435	—
Total	$6,189,852	$ 5,008,274

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At March 31, 2016 and December 31, 2015, the repurchase agreements had the following characteristics and remaining maturities:

	March 31, 2016 Collateral Type					
(in thousands)	Agency RMBS	Non-Agency RMBS [(1)]	Agency Derivatives	Residential Mortgage Loans Held-for-Sale	Commercial Real Estate Assets	Total Amount Outstanding
Within 30 days	$1,625,350	$659,316	$37,217	$ —	$57,587	$2,379,470
30 to 59 days	1,876,163	173,895	38,341	29,313	—	2,117,712
60 to 89 days	528,152	103,848	—	—	—	632,000
90 to 119 days	12,455	166,897	17,473	—	—	196,825
120 to 364 days	565,313	176,037	20,060	—	—	761,410
One year and over	—	—	—	—	102,435	102,435
Total	$4,607,433	$1,279,993	$113,091	$ 29,313	$160,022	$6,189,852
Weighted average borrowing rate	0.77 %	2.26 %	1.48 %	2.69 %	2.87 %	1.15 %

	December 31, 2015 Collateral Type					
(in thousands)	Agency RMBS	Non-Agency RMBS [(1)]	Agency Derivatives	Residential Mortgage Loans Held-for-Sale	Commercial Real Estate Assets	Total Amount Outstanding
Within 30 days	$1,719,292	$852,436	$58,286	$ —	$ 59,349	$2,689,363
30 to 59 days	1,407,353	271,819	60,065	—	—	1,739,237
60 to 89 days	143,051	15,691	2,707	—	—	161,449
90 to 119 days	68,014	106,007	1,465	—	—	175,486
120 to 364 days	—	234,229	—	8,510	—	242,739
Total	$3,337,710	$1,480,182	$122,523	$ 8,510	$ 59,349	$5,008,274
Weighted average borrowing rate	0.65 %	2.03 %	1.18 %	2.87 %	2.62 %	1.10 %

(1) Includes repurchase agreements collateralized by retained interests from the Company’s on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

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The following table summarizes assets at carrying values that are pledged or restricted as collateral for the future payment obligations of repurchase agreements:

(in thousands)	March 31, 2016	December 31, 2015
Available-for-sale securities, at fair value	$6,472,159	$ 5,354,104
Residential mortgage loans held-for-sale, at fair value	31,681	9,543
Commercial real estate assets	245,548	108,958
Net economic interests in consolidated securitization trusts [(1)]	274,718	274,949
Cash and cash equivalents	15,000	15,000
Restricted cash	50,543	119,310
Due from counterparties	22,401	10,211
Derivative assets, at fair value	157,212	157,879
Total	$7,269,262	$ 6,049,954

(1) Includes the retained interests from the Company’s on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

Although the transactions under repurchase agreements represent committed borrowings until maturity, the respective lender retains the right to mark the underlying collateral to fair value. A reduction in the value of pledged assets would require the Company to provide additional collateral or fund margin calls.
The following table summarizes certain characteristics of the Company’s repurchase agreements and counterparty concentration at March 31, 2016 and December 31, 2015:

	March 31, 2016				December 31, 2015			
(dollars in thousands)	Amount Outstanding	Net Counterparty Exposure [(1)]	Percent of Equity	Weighted Average Days to Maturity	Amount Outstanding	Net Counterparty Exposure [(1)]	Percent of Equity	Weighted Average Days to Maturity
Royal Bank of Canada	$691,801	$ 205,517	6 %	56.1	$799,527	$ 217,677	6 %	31.5
All other counterparties [(2)]	5,498,051	866,745	26 %	63.1	4,208,747	818,108	23 %	36.2
Total	$6,189,852	$ 1,072,262			$5,008,274	$ 1,035,785		

(1) Represents the net carrying value of the securities, residential mortgage loans held-for-sale and commercial real estate assets sold under agreements to repurchase, including accrued interest plus any cash or assets on deposit to secure the repurchase obligation, less the amount of the repurchase liability, including accrued interest. Payables due to broker counterparties for unsettled securities purchases of $796.2 million as of March 31, 2016 are not included in the amounts presented above. The Company did not have any such payables as of December 31, 2015.
(2) Represents amounts outstanding with 19 and 20 counterparties at March 31, 2016 and December 31, 2015, respectively.

The Company does not anticipate any defaults by its repurchase agreement counterparties. There can be no assurance, however, that any such default or defaults will not occur.

Note 16. Collateralized Borrowings in Securitization Trusts, at Fair Value
The Company purchases subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or the Company’s subsidiaries. The debt associated with the underlying residential mortgage loans held by the trusts, which are consolidated on the Company’s condensed consolidated balance sheets, is classified as

collateralized borrowings in securitization trusts and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities for additional information regarding consolidation of the securitization trusts. As of March 31, 2016 and December 31, 2015, collateralized borrowings in securitization trusts had a carrying value of $2.8 billion and $2.0 billion with a weighted average interest rate of 3.5% and 3.6%, respectively. The stated maturity dates for all collateralized borrowings were more than five years from both March 31, 2016 and December 31, 2015.

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Note 17. Federal Home Loan Bank of Des Moines Advances
The Company’s wholly owned subsidiary, TH Insurance Holdings Company LLC, or TH Insurance, is a member of the FHLB. As a member of the FHLB, TH Insurance has access to a variety of products and services offered by the FHLB, including secured advances. As of March 31, 2016 and December 31, 2015, TH Insurance had $4.0 billion and $3.8 billion in outstanding secured advances with a weighted average borrowing rate of 0.59% and 0.58%, respectively, and had no additional uncommitted capacity to borrow as of March 31, 2016. As of December 31, 2015, TH Insurance had an additional $215.0 million of available uncommitted capacity for borrowings. To the extent TH Insurance has uncommitted capacity, it may be adjusted at the sole discretion of the FHLB.
The ability to borrow from the FHLB is subject to the Company’s continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with the FHLB. Each advance requires approval by the FHLB and is secured by collateral in accordance with the FHLB’s credit and collateral guidelines, as may be revised from time to time by the FHLB. Eligible collateral may include conventional 1-4 family residential mortgage loans, commercial real estate loans, Agency RMBS and certain non-Agency RMBS with a rating of A and above.
On January 11, 2016, the Federal Housing Finance Agency, or FHFA, released a final rule regarding membership in the Federal Home Loan Bank system. Among other effects, the final rule excludes captive insurers from membership eligibility, including the Company’s subsidiary member, TH Insurance. Since TH Insurance was admitted as a member in 2013, it is eligible for a five-year membership grace period, during which new advances or renewals that mature beyond the grace period will be prohibited; however, any existing advances that mature beyond this grace period will be permitted to remain in place subject to their terms insofar as the Company maintains good standing with the FHLB. If any new advances or renewals occur, TH Insurance’s outstanding advances will be limited to 40% of its total assets.
At March 31, 2016 and December 31, 2015, FHLB advances had the following remaining maturities:

(in thousands)	March 31, 2016	December 31, 2015
≤ 1 year	$428,238	$ —
> 1 and ≤ 3 years	223,000	651,238
> 3 and ≤ 5 years	815,024	815,024
> 5 and ≤ 10 years	—	—
> 10 years	2,533,738	2,318,738
Total	$4,000,000	$ 3,785,000

The following table summarizes assets at carrying values that are pledged or restricted as collateral for the future payment obligations of FHLB advances:

(in thousands)	March 31, 2016	December 31, 2015
Available-for-sale securities, at fair value	$2,984,562	$ 2,412,970
Residential mortgage loans held-for-sale, at fair value	291,533	735,911
Commercial real estate assets	421,239	252,172
Net economic interests in consolidated securitization trusts [1]	780,231	863,363
Total	$4,477,565	$ 4,264,416

(1) Includes the retained interests from the Company’s on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

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The FHLB retains the right to mark the underlying collateral for FHLB advances to fair value. A reduction in the value of pledged assets would require the Company to provide additional collateral. In addition, as a condition to membership in the FHLB, the Company is required to purchase and hold a certain amount of FHLB stock, which is based, in part, upon the outstanding principal balance of advances from the FHLB. At March 31, 2016 and December 31, 2015, the Company had stock in the FHLB totaling $167.9 million and $156.7 million, respectively, which is included in other assets on the condensed consolidated balance sheets. FHLB stock is considered a non-marketable, long-term investment, is carried at cost and is subject to recoverability testing under applicable accounting standards. This stock can only be redeemed or sold at its par value, and only to the FHLB. Accordingly, when evaluating FHLB stock for impairment, the Company considers the ultimate recoverability of the par value rather than recognizing temporary declines in value. As of March 31, 2016 and December 31, 2015, the Company had not recognized an impairment charge related to its FHLB stock.

Note 18. Stockholders’ Equity
Distributions to Stockholders
The following table presents cash dividends declared by the Company on its common stock during the three months ended March 31, 2016, and the four immediately preceding quarters:

Declaration Date	Record Date	Payment Date	Cash Dividend Per Share
March 15, 2016	March 31, 2016	April 21, 2016	$ 0.23
December 16, 2015	December 30, 2015	January 20, 2016	$ 0.26
September 16, 2015	September 30, 2015	October 22, 2015	$ 0.26
June 17, 2015	June 30, 2015	July 21, 2015	$ 0.26
March 18, 2015	March 31, 2015	April 21, 2015	$ 0.26

Accumulated Other Comprehensive Income
Accumulated other comprehensive income at March 31, 2016 and December 31, 2015 was as follows:

(in thousands)	March 31, 2016	December 31, 2015
Available-for-sale securities		
Unrealized gains	$410,764	$ 405,177
Unrealized losses	(30,358)	(46,116)
Accumulated other comprehensive income	$380,406	$ 359,061

Reclassifications out of Accumulated Other Comprehensive Income
The following table summarizes reclassifications out of accumulated other comprehensive income for the three months ended March 31, 2016 and 2015:

(in thousands)	Affected Line Item in the Condensed Consolidated Statements of Comprehensive (Loss) Income	Amount Reclassified out of Accumulated Other Comprehensive Income Three Months Ended March 31, 2016	2015
	Total other-than-temporary impairment losses	$717	$127

Other-than-temporary impairments on AFS securities			
Realized gains on sales of certain AFS securities, net of tax	Gain on investment securities	(19,126)	(99,935)
Total		$(18,409)	$(99,808)

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Dividend Reinvestment and Direct Stock Purchase Plan
The Company sponsors a dividend reinvestment and direct stock purchase plan through which stockholders may purchase additional shares of the Company's common stock by reinvesting some or all of the cash dividends received on shares of the Company's common stock. Stockholders may also make optional cash purchases of shares of the Company's common stock subject to certain limitations detailed in the plan prospectus. An aggregate of 7.5 million shares of the Company's common stock were originally reserved for issuance under the plan. As of March 31, 2016, 297,940 shares have been issued under the plan for total proceeds of approximately $3.1 million, of which 14,648 and 19,412 shares were issued for total proceeds of $109,648 and $200,264 during the three months ended March 31, 2016 and 2015, respectively.
Share Repurchase Program
As of December 31, 2015, the Company's share repurchase program allowed the Company to repurchase up to 25,000,000 shares of its common stock. During the three months ended March 31, 2016, the Company's board of directors authorized an increase of 50,000,000 shares, for up to a total of 75,000,000 shares authorized under the program. Shares may be repurchased from time to time through privately negotiated transactions or open market transactions, pursuant to a trading plan in accordance with Rules 10b5-1 and 10b-18 under the Securities Exchange Act of 1934, as amended, or the Exchange Act, or by any combination of such methods. The manner, price, number and timing of share repurchases are subject to a variety of factors, including market conditions and applicable SEC rules. The share repurchase program does not require the purchase of any minimum number of shares, and purchases may be commenced or suspended at any time without prior notice. The share repurchase program does not have an expiration date. As of March 31, 2016, a total of 24,135,000 shares had been repurchased by the Company under the program for an aggregate cost of $200.4 million; of these, 8,020,000 shares were repurchased for a total cost of $61.3 million during the three months ended March 31, 2016. No shares were repurchased during the three months ended March 31, 2015.
At-the-Market Offering
On May 25, 2012, the Company entered into an equity distribution agreement under which the Company may sell up to an aggregate of 20,000,000 shares of its common stock from time to time in any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 under the Securities Act of 1933, as amended, or the Securities Act. On May 22, 2015, the Company entered into an amendment to the equity distribution agreement providing that any subsequent offers or sales of the Company's common stock under the equity distribution agreement shall be made pursuant to a new prospectus supplement, which was filed on the same date. As of March 31, 2016, 7,585,869 shares of common stock have been sold under the equity distribution agreement for total accumulated net proceeds of approximately $77.6 million; however, no shares were sold during the three months ended March 31, 2016 and 2015.

Note 19. Equity Incentive Plan
On May 14, 2015, the Company's stockholders approved the Company's Second Restated 2009 Equity Incentive Plan, which replaced the previous Restated 2009 Equity Incentive Plan, both of which are referred to collectively as the Plan. This stockholder approval effectuated, among other changes, an increase in the number of shares of common stock available for issuance under the Plan by 10,000,000 shares, to a total of 13,000,000 shares.
During the three months ended March 31, 2016 and 2015, the Company granted 1,677,998 and 206,275 shares of restricted common stock, respectively, to key employees of PRCM Advisers pursuant to the terms of the Plan and the associated award agreements. The estimated fair value of these awards was $7.33 and $10.30 per share on grant date, based on the closing market price of the Company's common stock on the NYSE on such date. However, as the cost of these awards is measured at fair value at each reporting date based on the price of the Company's stock as of period end in accordance with ASC 505, Equity, or ASC 505, the fair value of these awards as of March 31, 2016 was $7.94 per share based on the closing market price of the Company's common stock on the NYSE on such date. The shares underlying the grants vest in three equal annual installments commencing on the first anniversary of the grant date, as

long as such grantee complies with the terms and conditions of his or her applicable restricted stock award agreement.

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The following table summarizes the activity related to restricted common stock for the three months ended March 31, 2016 and 2015:

	Three Months Ended March 31,			
	2016		2015	
(in thousands)	Shares	Weighted Average Grant Date Fair Market Value	Shares	Weighted Average Grant Date Fair Market Value
Outstanding at Beginning of Period	2,290,609	$ 10.36	2,002,406	$ 10.32
Granted	1,677,998	7.33	206,275	10.30
Vested	(414,744)	(9.88)	(365,662)	(9.79)
Forfeited	(16,683)	(8.99)	(55,474)	(10.19)
Outstanding at End of Period	3,537,180	$ 8.99	1,787,545	$ 10.43

For the three months ended March 31, 2016 and 2015, the Company recognized compensation costs related to restricted common stock of $2.9 million and $2.7 million, respectively.

Note 20. Income Taxes

For the three months ended March 31, 2016 and 2015, the Company qualified to be taxed as a REIT under the Code for U.S. federal income tax purposes. As long as the Company qualifies as a REIT, the Company generally will not be subject to U.S. federal income taxes on its taxable income to the extent it annually distributes its net taxable income to stockholders, and does not engage in prohibited transactions. The Company intends to distribute 100% of its REIT taxable income and comply with all requirements to continue to qualify as a REIT. The majority of states also recognize the Company’s REIT status. The Company’s TRSs file separate tax returns and are fully taxed as standalone U.S. C-corporations. It is assumed that the Company will retain its REIT status and will incur no REIT level taxation as it intends to comply with the REIT regulations and annual distribution requirements.
During the three months ended March 31, 2016 and 2015, the Company’s TRSs recognized a provision for income taxes of $5.5 million and a benefit from income taxes of $10.7 million, which was primarily due to gains recognized and losses incurred, respectively, on derivative instruments held in the Company’s TRSs.
Based on the Company’s evaluation, it has been concluded that there are no significant uncertain tax positions requiring recognition in the Company’s condensed consolidated financial statements of a contingent tax liability for uncertain tax positions.

Note 21. Earnings Per Share

The following table presents a reconciliation of the (loss) earnings and shares used in calculating basic and diluted (loss) earnings per share for the three months ended March 31, 2016 and 2015:

	Three Months Ended March 31,	
(in thousands, except share data)	2016	2015
Numerator:		
Net (loss) income	$(88,930)	$ 94,793
Denominator:		
Weighted average common shares outstanding	346,197,193	364,629,176
Weighted average restricted stock shares	3,238,822	1,878,481

Basic and diluted weighted average shares outstanding	349,436,015	366,507,657
Basic and Diluted (Loss) Earnings Per Share	$(0.25)	$ 0.26

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Note 22. Related Party Transactions

The following summary provides disclosure of the material transactions with affiliates of the Company.

In accordance with its management agreement with PRCM Advisers, the Company incurred $12.0 million and $12.7 million as a management fee to PRCM Advisers for the three months ended March 31, 2016 and 2015, respectively, which represents approximately 1.5% of stockholders' equity on an annualized basis as defined by the Management Agreement. For purposes of calculating the management fee, stockholders' equity is adjusted to exclude any common stock repurchases as well as any unrealized gains, losses or other items that do not affect realized net (loss) income, among other adjustments, in accordance with the Management Agreement. In addition, the Company reimbursed PRCM Advisers for direct and allocated costs incurred by PRCM Advisers on behalf of the Company. These direct and allocated costs totaled approximately $6.8 million and $4.8 million for the three months ended March 31, 2016 and 2015, respectively

The Company has an established accounts payable function and direct relationships with the majority of its third-party vendors. The Company will continue to have certain costs allocated to it by PRCM Advisers for compensation, data services and proprietary technology, but most direct expenses with third-party vendors are paid directly by the Company.

The Company recognized $2.9 million and $2.7 million of compensation expense during the three months ended March 31, 2016 and 2015, respectively, related to restricted common stock issued to employees of PRCM Advisers pursuant to the Plan. See Note 19 - Equity Incentive Plan for additional information.

Note 23. Subsequent Events

Events subsequent to March 31, 2016, were evaluated through the date these financial statements were issued and no additional events were identified requiring further disclosure in these condensed consolidated financial statements.

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

The following discussion and analysis should be read in conjunction with our unaudited condensed consolidated financial statements and accompanying notes included elsewhere in this Quarterly Report on Form 10-Q as well as our Annual Report on Form 10-K for the year ended December 31, 2015.

General

We are a Maryland corporation focused on investing in, financing and managing residential mortgage-backed securities, or RMBS, residential mortgage loans, mortgage servicing rights, or MSR, commercial real estate and other financial assets, which we collectively refer to as our target assets. We operate as a real estate investment trust, or REIT, as defined under the Internal Revenue Code of 1986, as amended, or the Code.

We are externally managed by PRCM Advisers LLC, or PRCM Advisers, which is a wholly owned subsidiary of Pine River Capital Management L.P., or Pine River, a global multi-strategy asset management firm providing comprehensive portfolio management, transparency and liquidity to institutional and high net worth investors.

Our objective is to provide attractive risk-adjusted total return to our stockholders over the long term, primarily through dividends and secondarily through capital appreciation. We selectively acquire and manage an investment portfolio of our target assets, which is constructed to generate attractive returns through market cycles. We focus on asset selection and implement a relative value investment approach across various sectors within the mortgage market. Our target assets include the following:

- Agency RMBS (which includes inverse interest-only Agency securities classified as "Agency Derivatives" for purposes of U.S. generally accepted accounting principles, or U.S. GAAP), meaning RMBS whose principal and interest payments are guaranteed by the Government National Mortgage Association (or Ginnie Mae), the Federal National Mortgage Association (or Fannie Mae), or the Federal Home Loan Mortgage Corporation (or Freddie Mac), or collectively, the government sponsored entities, or GSEs;
- Non-Agency RMBS, meaning RMBS that are not issued or guaranteed by Ginnie Mae, Fannie Mae or Freddie Mac;
- Residential mortgage loans;
- MSR;
- Commercial real estate assets; and
- Other financial assets comprising approximately 5% to 10% of the portfolio.

We generally view our target assets in three strategies that are based on our core competencies of understanding and managing prepayment and credit risk. Our rates strategy includes assets that are sensitive to changes in interest rates and prepayment speeds, specifically Agency RMBS and MSR. Our credit strategy includes assets with inherent credit risk including non-Agency RMBS, net economic interests in consolidated securitization trusts and prime nonconforming residential mortgage loans. Our commercial strategy includes as target assets first mortgage loans, mezzanine loans, b-notes and preferred equity.

As opportunities in the residential and commercial mortgage marketplace change, we continue to evolve our business model. From a capital allocation perspective, we expect to continue to increase our allocation towards MSR, residential mortgage loans and commercial real estate assets, and decrease our exposure to RMBS over time. During the three months ended March 31, 2016, however, we increased our allocation towards Agency RMBS due to attractive market prices. Within our non-Agency RMBS portfolio, we have historically had a substantial emphasis on "legacy" securities, which include securities issued prior to 2009. Throughout the past year, however, we have sold a number of these securities that we believe had reached maximum value, some of which were replaced with "new issue" non-Agency RMBS. We believe these "new issue" securities, which include some GSE credit risk transfer securities, have enabled us to find attractive returns and further diversify our non-Agency RMBS portfolio.

Within our mortgage loan conduit and securitization business, we acquire prime nonconforming residential mortgage loans from select mortgage loan originators and secondary market institutions with the intent to securitize the loans through the issuance of non-Agency mortgage-backed securities. Our intention is to retain the related subordinated securities, representing the credit risk piece associated with these deals. We also hold a small legacy portfolio of credit sensitive residential mortgage loans, or CSL, which are loans that were performing, but with respect to which the borrower had previously experienced payment delinquencies and was more likely to be underwater (i.e., the amount owed on a mortgage loan exceeds the current market value of the home). As a result, there is a higher probability of default on CSL than on newly originated residential mortgage loans. We do not originate residential mortgage loans or provide direct financing to lenders; rather, through our mortgage loan conduit we contract with originators to acquire loans they originate that meet our purchase criteria.

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Within our MSR business, we purchase the right to control the servicing of mortgage loans from high-quality originators. Additionally, as an owner of MSR on loans from securitizations guaranteed by Ginnie Mae, we are obligated to purchase these loans from time to time in order to complete modifications on the mortgage loans or to convey foreclosed properties to the U.S. Department of Housing and Urban Development, or HUD. We also have the option to buy out delinquent mortgages in order to better control loss mitigation activities. We held a small portfolio of these Ginnie Mae buyout residential mortgage loans as of March 31, 2016. We do not directly service the mortgage loans we acquire, nor the mortgage loans underlying the MSR we acquire; rather, we contract with fully licensed third-party subservicers to handle substantially all servicing functions.

We believe our investment model allows management to allocate capital across various sectors within the mortgage market, with a focus on asset selection and the implementation of a relative value investment approach. Our capital allocation decisions factor in the opportunities in the marketplace, the cost of financing and the cost of hedging interest rate, prepayment, credit and other portfolio risks. As a result, capital allocation reflects management’s opportunistic approach to investing in the marketplace. The following table provides our capital allocation among the target assets in each of our investment strategies as of March 31, 2016 and the four immediately preceding period ends:

	As of				
	March 31, 2016	December 31, 2015	September 30, 2015	June 30, 2015	March 31, 2015
Rates strategy					
Agency RMBS	43%	35%	41%	44%	45%
Mortgage servicing rights	13%	14%	12%	11%	10%
Credit strategy					
Non-Agency RMBS	22%	27%	30%	33%	34%
Mortgage loan conduit/securitization	11%	16%	13%	12%	11%
Commercial strategy	11%	8%	4%	< 1%	< 1%

As our capital allocation shifts, our annualized yields and cost of financing shift. As previously discussed, our investment decisions are not driven solely by annualized yields, but rather a multitude of macroeconomic drivers, including market environments and their respective impacts (e.g., uncertainty of prepayment speeds, extension risk and credit events).

For the three months ended March 31, 2016, our net yield realized on the portfolio was higher than previous periods. Yields and net interest spreads on non-Agency RMBS and MSR are generally higher than recent quarters, while yields and spreads on Agency RMBS have generally decreased. Net yields on residential mortgage loans held-for-sale and net economic interests in consolidated securitization trusts have been relatively consistent. Additionally, our cost of financing has decreased as a result of lower swap spread. The following table provides the average annualized yield on our target assets, including Agency and non-Agency RMBS, residential mortgage loans held-for-sale, residential mortgage loans held-for-investment, net of collateralized borrowings, in securitization trusts, commercial real estate assets and MSR for the three months ended March 31, 2016, and the four immediately preceding quarters:

	Three Months Ended				
	March 31, 2016	December 31, 2015	September 30, 2015	June 30, 2015	March 31, 2015
Average annualized portfolio yield (1)	4.58%	4.56%	4.14%	4.16%	4.40%
Cost of financing (2)	1.21%	1.30%	1.31%	1.37%	1.33%
Net portfolio yield	3.37%	3.26%	2.83%	2.79%	3.07%

(1) Average annualized yield incorporates future prepayment, credit loss and other assumptions, all of which are estimates and subject to change.

(2) Cost of financing includes swap interest rate spread.

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We seek to deploy moderate leverage as part of our investment strategy. We generally finance our RMBS, residential mortgage loans held-for-sale and commercial real estate assets through short- and long-term borrowings structured as repurchase agreements and through short- and long-term advances from the Federal Home Loan Bank of Des Moines, or the FHLB. Our Agency RMBS, given their liquidity and high credit quality, are eligible for higher levels of leverage, while non-Agency RMBS, residential mortgage loans held-for-sale and commercial real estate assets, with less liquidity and more exposure to credit risk, utilize lower levels of leverage. We believe the debt-to-equity ratio funding our Agency RMBS, non-Agency RMBS, residential mortgage loans held-for-sale and commercial real estate assets is the most meaningful leverage measure as collateralized borrowings on residential mortgage loans held-for-investment in securitization trusts represents term financing with no stated maturity. As a result, our debt-to-equity ratio is determined by our portfolio mix as well as many additional factors, including the liquidity of our portfolio, the sustainability and price of our financing, diversification of our counterparties and their available capacity to finance our assets, and anticipated regulatory developments. Over the past several quarters, we have generally maintained a debt-to-equity ratio range of 3.0 to 5.0 times to finance our RMBS portfolio, residential mortgage loans held-for-sale and commercial real estate assets, on a fully deployed capital basis. Our debt-to-equity ratio is directly correlated to the make-up of our portfolio; specifically, the higher percentage of Agency RMBS we hold, the higher our debt-to-equity ratio is, while the higher percentage of non-Agency RMBS, mortgage loans and commercial real estate assets we hold, the lower our debt-to-equity ratio is. We may alter the percentage allocation of our portfolio among our target assets depending on the relative value of the assets that are available to purchase from time to time, including at times when we are deploying proceeds from common stock offerings we conduct. See the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Financial Condition - Repurchase Agreements” for further discussion.

We recognize that investing in our target assets is competitive and that we compete with other entities for attractive investment opportunities. We rely on our management team and our dedicated team of investment professionals provided by our external manager to identify investment opportunities. In addition, we have benefited and expect to continue to benefit from our external manager’s analytical and portfolio management expertise and infrastructure. We believe that our significant focus in the mortgage market, the extensive mortgage market expertise of our investment team, our strong analytics and our disciplined relative value investment approach give us a competitive advantage versus our peers.

We have elected to be treated as a REIT for U.S. federal income tax purposes. To qualify as a REIT we are required to meet certain investment and operating tests and annual distribution requirements. We generally will not be subject to U.S. federal income taxes on our taxable income to the extent that we annually distribute all of our net taxable income to stockholders, do not participate in prohibited transactions and maintain our intended qualification as a REIT. However, certain activities that we may perform may cause us to earn income which will not be qualifying income for REIT purposes. We have designated certain of our subsidiaries as taxable REIT subsidiaries, or TRSs, as defined in the Code, to engage in such activities, and we may form additional TRSs in the future. We also operate our business in a manner that will permit us to maintain our exemption from registration under the Investment Company Act of 1940, as amended, or the 1940 Act. While we do not currently originate or service residential mortgage loans, certain of our subsidiaries have obtained the requisite licenses and approvals to purchase and sell residential mortgage loans in the secondary market and to own and manage MSR. Additionally, certain of our subsidiaries are licensed to originate commercial real estate loans.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains, or incorporates by reference, not only historical information, but also forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act, and that are subject to the safe harbors created by such sections. Forward-looking statements involve numerous risks and uncertainties. Our actual results may differ from our beliefs, expectations, estimates, and projections and, consequently, you should not rely on these forward-looking statements as predictions of future events. Forward-looking statements are not historical in nature and can be identified by words such as "anticipate," "estimate," "will," "should," "expect," "target," "believe," "inten "plan," "goals," "future," "likely," "may" and similar expressions or their negative forms, or by references to strategy, plans, o intentions. These forward-looking statements are subject to risks and uncertainties, including, among other things, those described in our Annual Report on Form 10-K for the year ended December 31, 2015, under the caption "Risk Factors." Other risks, uncertainties and factors that could cause actual results to differ materially from those projected are described below and may be described from time to time in reports we file with the Securities and Exchange Commission, or SEC, including our Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update or revise any such forward-looking statements, whether as a result of new information, future events, or otherwise.

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Important factors, among others, that may affect our actual results include:

- changes in interest rates and the market value of our target assets;
- changes in prepayment rates of mortgages underlying our target assets;
- the occurrence, extent and timing of credit losses within our portfolio;
- our exposure to adjustable-rate and negative amortization mortgage loans underlying our target assets;
- the state of the credit markets and other general economic conditions, particularly as they affect the price of earning assets and the credit status of borrowers;
- the concentration of the credit risks to which we are exposed;
- legislative and regulatory actions affecting our business;
- the availability and cost of our target assets;
- the availability and cost of financing for our target assets, including repurchase agreement financing, lines of credit and financing through the FHLB;
- declines in home prices;
- increases in payment delinquencies and defaults on the mortgages comprising and underlying our target assets;
- changes in liquidity in the market for real estate securities, the re-pricing of credit risk in the capital markets, inaccurate ratings of securities by rating agencies, rating agency downgrades of securities, and increases in the supply of real estate securities available-for-sale;
- changes in the values of securities we own and the impact of adjustments reflecting those changes on our condensed consolidated statements of comprehensive (loss) income and balance sheets, including our stockholders' equity;
- our ability to generate cash flow from our target assets;
- changes in our investment, financing and hedging strategies and the new risks to which those changes may expose us;
- changes in the competitive landscape within our industry, including changes that may affect our ability to attract and retain personnel;
- our ability to build and maintain successful relationships with loan originators;
- our ability to acquire mortgage loans in connection with our mortgage loan conduit program;
- our ability to securitize the mortgage loans that we acquire;
- our exposure to legal and regulatory claims, penalties or enforcement activities, including those arising from our involvement in securitization transactions and ownership and management of MSR;
- our exposure to counterparties involved in our mortgage loan conduit and MSR businesses and our ability to enforce representations and warranties made by them;
- our ability to acquire MSR and successfully operate our seller-servicer subsidiary and oversee the activities of our subservicers;
- the state of commercial real estate markets, including the demand for commercial loans;
- our ability to acquire commercial real estate assets, and to originate commercial loans;
- our ability to successfully diversify our business into new asset classes, and manage the new risks to which they may expose us;
- our ability to manage various operational and regulatory risks associated with our business;
- interruptions in or impairments to our communications and information technology systems;
- our ability to maintain appropriate internal controls over financial reporting;
- our ability to establish, adjust and maintain appropriate hedges for the risks in our portfolio;
- our ability to maintain our REIT qualification for U.S. federal income tax purposes; and
- limitations imposed on our business due to our REIT status and our status as exempt from registration under the 1940 Act.

This Quarterly Report on Form 10-Q may contain statistics and other data that, in some cases, have been obtained or compiled from information made available by mortgage loan servicers and other third-party service providers.

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Factors Affecting our Operating Results

Our net interest income includes income from our RMBS portfolio, including the amortization of purchase premiums and accretion of purchase discounts, and income from our residential mortgage loans and commercial real estate assets. Net interest income, as well as our servicing income, net of subservicing expenses, will fluctuate primarily as a result of changes in market interest rates, our financing costs, and prepayment speeds on our assets. Interest rates, financing costs and prepayment rates vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty. Our operating results will also be affected by default rates and credit losses with respect to the mortgage loans underlying our non-Agency RMBS and in our residential mortgage loan and commercial real estate portfolios.

Fair Value Measurement

A significant portion of our assets and liabilities are reported at fair value and, therefore, our condensed consolidated balance sheets and statements of comprehensive (loss) income are significantly affected by fluctuations in market prices. At March 31, 2016, approximately 85.8% of total assets, or $14.3 billion, and approximately 21.7% of total liabilities, or $2.9 billion, consisted of financial instruments recorded at fair value. See Note 14 - Fair Value to the condensed consolidated financial statements, included in this Quarterly Report on Form 10-Q, for descriptions of valuation methodologies used to measure material assets and liabilities at fair value and details of the valuation models, key inputs to those models and significant assumptions utilized. Although we execute various hedging strategies to mitigate our exposure to changes in fair value, we cannot fully eliminate our exposure to volatility caused by fluctuations in market prices. Although markets for asset-backed securities, including RMBS, have modestly stabilized since the severe dislocations experienced as a result of the financial crisis, these markets continue to experience volatility and, as a result, our assets and liabilities will be subject to valuation adjustment as well as changes in the inputs we use to measure fair value.

Any temporary change in the fair value of our available-for-sale, or AFS, securities, excluding Agency interest-only mortgage-backed securities and GSE credit risk transfer securities, is recorded as a component of accumulated other comprehensive income and does not impact our earnings. Our reported (loss) earnings for U.S. GAAP purposes, or GAAP net (loss) income, is affected, however, by fluctuations in market prices on the remainder of our financial assets and liabilities recorded at fair value. For the three months ended March 31, 2016, our unrealized fair value losses on interest rate swap and swaption agreements, which are accounted for as derivative trading instruments under U.S. GAAP, negatively affected our financial results. The change in fair value of the interest rate swaps was a result of changes to LIBOR, the swap curve and corresponding counterparty borrowing rates during the three months ended March 31, 2016. Our financial results for the three months ended March 31, 2016 were positively affected by unrealized fair value gains on Agency interest-only mortgage-backed securities and GSE credit risk transfer securities, residential mortgage loans held-for-sale and net economic interests in consolidated securitization trusts, and negatively affected by unrealized fair value losses on MSR.

For the three months ended March 31, 2015, our unrealized fair value losses on interest rate swap and swaption agreements negatively affected our financial results. The change in fair value of the interest rate swaps was a result of changes to LIBOR, the swap curve and corresponding counterparty borrowing rates during the three months ended March 31, 2015. Our financial results for the three months ended March 31, 2015 were positively affected by unrealized fair value gains on certain U.S. Treasuries classified as trading instruments, residential mortgage loans held-for-sale and net economic interests in consolidated securitization trusts, and negatively affected by unrealized fair value losses on MSR.

In addition, our financial results for the three months ended March 31, 2016 and 2015 were affected by the unrealized gains and losses of certain other derivative instruments that were accounted for as trading derivative instruments (i.e., credit default swaps, TBAs, short U.S. Treasuries, put and call options for TBAs and U.S. Treasuries, constant maturity swaps, Markit IOS total return swaps, inverse interest-only securities and forward residential mortgage loan purchase commitments).

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We have numerous internal controls in place to help ensure the appropriateness of fair value measurements. Significant fair value measures are subject to detailed analytics and management review and approval. Our entire investment portfolio is priced by third-party brokers and/or by independent pricing providers. We generally receive three or more broker and vendor quotes on pass-through Agency RMBS, and generally receive multiple broker or vendor quotes on all other RMBS instruments, including interest-only Agency RMBS, inverse interest-only Agency RMBS, and non-Agency RMBS. We also typically receive two vendor quotes for the residential mortgage loans and MSR in our investment portfolio. For Agency RMBS, the third-party pricing providers and brokers use pricing models that commonly incorporate such factors as coupons, primary and secondary mortgage rates, rate reset period, issuer, prepayment speeds, credit enhancements and expected life of the security. For non-Agency RMBS, the third-party pricing providers and brokers utilize both observable and unobservable inputs such as pool specific characteristics (i.e., loan age, loan size, credit quality of borrowers, vintage, servicer quality), floating rate indices, prepayment and default assumptions, and recent trading of the same or similar securities. For residential mortgage loans and MSR, vendors use pricing models that generally incorporate observable inputs such as principal balance, note rate, geographical location, loan-to-value (LTV) ratios, FICO, appraised value and other loan characteristics, along with observed market yields, securitization economics and trading levels. Additionally for MSR, pricing providers will customarily incorporate loan servicing cost, servicing fee, ancillary income, and earnings rate on escrow as observable inputs. Unobservable or model-driven inputs include forecast cumulative defaults, default curve, forecast loss severity and forecast voluntary prepayment.

We evaluate the prices we receive from both brokers and independent pricing providers by comparing those prices to actual purchase and sale transactions, our internally modeled prices calculated based on market observable rates and credit spreads, and to each other both in current and prior periods. We review and may challenge broker quotes and valuations from third-party pricing providers to ensure that such quotes and valuations are indicative of fair value as a result of this analysis. We then estimate the fair value of each security based upon the median of the final broker quotes received, and we estimate the fair value of residential mortgage loans and MSR based upon the average of prices received from independent providers, subject to internally-established hierarchy and override procedures.

We utilize “bid side” pricing for our RMBS assets and, as a result, certain assets, especially the most recent purchases, may realize a markdown due to the “bid-offer” spread. To the extent that this occurs, any economic effect of this would be reflected in accumulated other comprehensive income.

Considerable judgment is used in forming conclusions and estimating inputs to our Level 3 fair value measurements. Level 3 inputs such as interest rate movements, prepayments speeds, credit losses and discount rates are inherently difficult to estimate. Changes to these inputs can have a significant effect on fair value measurements. Accordingly, there is no assurance that our estimates of fair value are indicative of the amounts that would be realized on the ultimate sale or exchange of these assets.

Market Conditions and Outlook

The key macroeconomic factors that impact our business are home prices and the employment and interest rate environments. Home prices increased modestly through the first quarter of 2016, and are expected to gradually appreciate over the next several years. Credit standards remain tight, despite a modest easing in recent months, and have limited borrowers’ ability to refinance their mortgages notwithstanding low interest rates and government programs that promote refinancing. Employment market conditions remain relatively solid as jobless claims, unemployment and payroll data are showing stabiliity, although underemployment levels remain stubbornly high and new job creation has been disappointing. Other than LTV ratios and cash reserves, we believe employment is the most powerful determinant of homeowners’ ongoing likelihood to pay their mortgages. Home price performance and employment are particularly important to our non-Agency portfolio.

The interest rate environment remained volatile in the first quarter of 2016 after the Federal Reserve’s rate hike announcement in December 2015. The low interest rate environment is expected to persist in the near term, however, as the Federal Reserve has suggested it will take a measured and conservative approach to future interest rate decisions. Additionally, it appears the Federal Reserve will continue to reinvest its mortgage-backed security principal repayments for the foreseeable future.

The U.S. economy continues to navigate headwinds that include global economic lethargy, specifically in China; geopolitical unrest across various regions worldwide; the ongoing European debt crisis; quantitative easing by the European Central Bank; and persistently high underemployment.

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Regulatory and legislative actions taken in the past few years in an effort to improve economic conditions and increase liquidity in the financial markets, as well as other actions related to the fall-out from the financial and foreclosure crises, continue to impact the market. Regulatory actions that could affect the value and availability of our target assets, either positively or negatively, include: attempts by the U.S. government to further simplify the refinancing process to allow more borrowers to refinance into lower interest rate mortgage loans; the streamlined loan modification initiative for borrowers that are 90+ days delinquent implemented by the GSEs; the real estate owned, or REO, to-rental program supported by the GSEs; the extension of both the Home Affordable Modification Program, or HAMP, and the Home Affordable Refinance Program 2.0, or HARP 2.0, through 2016; the strict “ability-to-repay” and “qualified mortgage” regulations promulgated by the Consumer Financial Protection Bureau, or the CFPB; the compliance with, enforcement of and potential liability associated with the new TILA-RESPA Integrated Disclosure, or TRID, rules recently implemented by the CFPB; and the application of the risk retention requirements of Section 15G of the Exchange Act.

There have also been a number of legislative proposals aimed at eventually winding down or phasing out the GSEs. It remains uncertain as to whether any such proposal will ultimately become legislation, as recent efforts appear to have little momentum in Congress. We will continue to monitor these and other regulatory and policy activities closely.

In 2014, the U.S. Department of Treasury, or the Treasury, requested comment on the development of a responsible private label securities market. We believe that private capital, through the private label securities market, is a critical component to the long-term stability of the mortgage market and, accordingly, submitted a comment letter in response to the request. The Treasury echoes our sentiment that a diverse housing finance system with numerous capital streams is critical to promoting competition, market efficiency, and consumer choice.

In January 2016, the FHFA released a final rule regarding membership in the Federal Home Loan Bank system. Among other effects, the final rule excludes captive insurers from membership eligibility, including our subsidiary member, TH Insurance Holdings Company LLC, or TH Insurance. Since TH Insurance was admitted as a member in 2013, it is eligible for a five-year membership grace period, during which new advances or renewals that mature beyond the grace period will be prohibited; however, any existing advances that mature beyond this grace period will be permitted to remain in place subject to their terms insofar as we maintain good standing with the FHLB. If any new advances or renewals occur, TH Insurance’s outstanding advances will be limited to 40% of its total assets. Notwithstanding the FHFA’s ruling, we continue to believe our mission aligns well with that of the Federal Home Loan Bank system.

We believe our blended Agency and non-Agency RMBS portfolio and our investing expertise, as well as our operational capabilities to invest in prime nonconforming residential mortgage loans, MSR and commercial real estate assets, will allow us to better navigate the dynamic mortgage market while future regulatory and policy activities take shape. Having a diversified portfolio allows us to mitigate a variety of risks, including interest rate and RMBS spread volatility. As such, we have diversified into several target assets that capitalize on our prepayment and credit expertise.

We expect that the majority of our assets will remain in whole-pool Agency RMBS in light of the long-term attractiveness of the asset class and in order to continue to satisfy the requirements of our exemption from registration under the 1940 Act. Interest-only Agency securities and MSR also provide a complementary investment and risk-management strategy to our principal and interest Agency RMBS investments. Risk-adjusted returns in our Agency RMBS portfolio may decline if we are required to pay higher purchase premiums due to lower interest rates or additional liquidity in the market. Additionally, the Federal Reserve’s prior quantitative easing programs and continued reinvestment of its mortgage-backed security principal repayments and other policy changes may impact the returns of our Agency RMBS portfolio.

The following table provides the carrying value of our RMBS portfolio by product type:

(dollars in thousands)	March 31, 2016	December 31, 2015
Agency		

Fixed Rate	$7,972,296	81.8%	$5,864,294	73.4%
Hybrid ARM	36,800	0.4 %	108,596	1.4 %
Total Agency	8,009,096	82.2%	5,972,890	74.8%
Agency Derivatives	157,219	1.6 %	157,906	2.0 %
Non-Agency				
Senior	1,172,288	12.0%	1,313,695	16.4%
Mezzanine	397,492	4.1 %	532,572	6.7 %
Interest-only securities	5,578	0.1 %	6,163	0.1 %
Total Non-Agency	1,575,358	16.2%	1,852,430	23.2%
Total	$9,741,673		$7,983,226	

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Prepayment speeds and volatility due to interest rates

Our Agency RMBS and MSR portfolios are subject to inherent prepayment risk. Generally, a decline in interest rates that leads to rising prepayment speeds will cause the market value of our interest-only securities and MSR to deteriorate, and our fixed coupon Agency pools to increase. The inverse relationship occurs when interest rates increase and prepayments slow. As previously discussed, despite the Federal Reserve raising rates in December 2015, the low interest rate environment is expected to persist in the near term. However, changes in home price performance, key employment metrics and government programs, among other macroeconomic factors, could cause prepayment speeds to increase on many RMBS, which could lead to less attractive reinvestment opportunities. Nonetheless, we believe our portfolio management approach, including our security selection process, positions us to ideally respond to a variety of market scenarios, including an overall faster prepayment environment.

Although we are unable to predict the movement in interest rates in 2016 and beyond, our diversified portfolio management strategy is intended to generate attractive yields with a low level of sensitivity to changes in the yield curve, prepayments and interest rate cycles.

Our Agency RMBS are collateralized by pools of fixed-rate mortgage loans and hybrid adjustable-rate mortgage loans, or hybrid ARMs, which are mortgage loans that have interest rates that are fixed for an initial period and adjustable thereafter. Our Agency portfolio also includes securities with implicit or explicit prepayment protection, including lower loan balances (securities collateralized by loans of less than $175,000 in initial principal balance) and HARP securities (pools that consist of borrowers who have refinanced through HARP, typically with loans with LTVs greater than or equal to 80%). Our overall allocation of Agency RMBS and holdings of pools with specific characteristics are viewed in the context of our aggregate rates strategy, including MSR and related derivative hedging instruments. Additionally, the selection of securities with certain attributes is driven by the perceived relative value of the securities, which factors in the opportunities in the marketplace, the cost of financing and the cost of hedging interest rate, prepayment, credit and other portfolio risks. As a result, Agency RMBS capital allocation reflects management's opportunistic approach to investing in the marketplace.

The following tables provide the carrying value of our Agency RMBS portfolio by underlying mortgage loan rate type:

	As of March 31, 2016						
(dollars in thousands)	Principal/ Current Face	Carrying Value	% of Agency Portfolio	% Lower Balance/ HARP	Weighted Average Coupon Rate	Amortized Cost	Weighted Average Loan Age (months)
Agency RMBS AFS:							
30-Year Fixed							
3.0-3.5%	$2,529,532	$2,649,806	32.4 %	— %	3.5 %	$2,638,968	2
4.0-4.5%	3,862,878	4,219,825	51.7 %	81.2 %	4.2 %	4,157,106	32
≥ 5%	537,807	610,068	7.5 %	73.7 %	5.5 %	580,902	86
	6,930,217	7,479,699	91.6 %	51.8 %	4.0 %	7,376,976	26
15-Year & Other Fixed	277,806	272,032	3.3 %	58.3 %	4.1 %	255,700	104
Hybrid ARM	34,318	36,800	0.5 %	— %	5.1 %	36,249	145
Interest-only	2,837,672	220,565	2.7 %	0.5 %	2.0 %	223,701	29
Agency Derivatives	882,726	157,219	1.9 %	— %	6.0 %	132,104	143
Total Agency RMBS	$10,962,739	$8,166,315	100.0 %	49.4 %		$8,024,730	

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(dollars in thousands)	As of December 31, 2015 Principal/ Current Face	Carrying Value	% of Agency Portfolio	% Lower Balance/ HARP	Weighted Average Coupon Rate	Amortized Cost	Weighted Average Loan Age (months)
Agency RMBS AFS:							
30-Year Fixed							
4.0-4.5%	$3,979,110	$4,290,199	70.0 %	81.2 %	4.2 %	$4,284,600	30
≥ 5%	561,874	632,954	10.3 %	73.8 %	5.5 %	607,318	84
	4,540,984	4,923,153	80.3 %	80.2 %	4.4 %	4,891,918	37
15-Year & Other Fixed	330,142	326,745	5.3 %	3.2 %	4.6 %	315,557	116
Home equity conversion mortgages	365,986	386,489	6.3 %	— %	4.5 %	383,771	43
Hybrid ARM	101,836	108,596	1.8 %	— %	3.6 %	106,293	142
Interest-only	2,918,082	227,907	3.7 %	0.4 %	2.1 %	232,299	29
Agency Derivatives	932,037	157,906	2.6 %	— %	6.1 %	139,859	140
Total Agency RMBS	$9,189,067	$6,130,796	100.0 %	66.3 %		$6,069,697	

We offset a portion of the Agency exposure to prepayment speeds through our non-Agency portfolio. Our non-Agency RMBS yields are expected to increase if prepayment rates on such assets exceed our prepayment assumptions. To the extent that prepayment speeds increase due to macroeconomic factors, we expect to benefit from the ability to recognize the income from the heavily discounted RMBS prices that principally arose from credit or payment default expectations.

The following tables provide discount information on our non-Agency RMBS portfolio:

(in thousands)	As of March 31, 2016 Principal and Interest Securities Senior	 Mezzanine	Interest-Only Securities	Total
Face Value	$1,616,961	$509,609	$ 219,031	$2,345,601
Unamortized discount				
Designated credit reserve	(319,213)	(33,863)	—	(353,076)
Unamortized net discount	(346,820)	(118,672)	(213,910)	(679,402)
Amortized Cost	$950,928	$357,074	$ 5,121	$1,313,123

(in thousands)	As of December 31, 2015 Principal and Interest Securities Senior	 Mezzanine	Interest-Only Securities	Total
Face Value	$1,801,283	$624,253	$ 229,845	$2,655,381
Unamortized discount				
Designated credit reserve	(373,729)	(35,348)	—	(409,077)
Unamortized net discount	(383,816)	(98,729)	(224,476)	(707,021)
Amortized Cost	$1,043,738	$490,176	$ 5,369	$1,539,283

Credit losses

Although our Agency portfolio is supported by U.S. government agency and federally chartered corporation guarantees of payment of principal and interest, we are exposed to credit risk in our non-Agency RMBS and residential mortgage and commercial real estate loans.

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The credit support built into non-Agency RMBS deal structures is designed to provide a level of protection from potential credit losses for more senior tranches. We evaluate credit risk on our non-Agency investments through a comprehensive asset selection process, which is predominantly focused on quantifying and pricing credit risk, including extensive initial modeling and scenario analysis. In addition, the discounted purchase prices paid for our non-Agency RMBS provide additional insulation from credit losses in the event we receive less than 100% of par on such assets. At purchase, we estimate the portion of the discount we do not expect to recover and factor that into our expected yield and accretion methodology. We may also record an other-than-temporary impairment, or OTTI, for a portion of our investment in a security to the extent we believe that the amortized cost exceeds the present value of expected future cash flows. We review our non-Agency RMBS on an ongoing basis using quantitative and qualitative analysis of the risk-adjusted returns on such investments and through on-going asset surveillance. Nevertheless, unanticipated credit losses could occur, adversely impacting our operating results.

We evaluate credit risk on our residential mortgage loans through a comprehensive asset selection process, which includes pre-acquisition due diligence and underwriting. We review our residential mortgage loans on an ongoing basis using quantitative and qualitative analysis and through on-going asset surveillance.

We also evaluate credit risk on our commercial real estate assets through a comprehensive asset selection process, which includes valuing the underlying collateral property as well as the financial and operating capability of the borrower, borrowing entity or loan sponsor. We also assess the financial wherewithal of any loan guarantors, the borrower's competency in managing and operating the properties, and the overall economic environment, real estate sector, and geographic sub-market in which the borrower operates. We evaluate each commercial real estate asset for impairment at least quarterly and may record an allowance to reduce the carrying value of the asset to the present value of expected future cash flows, if deemed impaired.

Counterparty exposure and leverage ratio

We monitor counterparty exposure in our broker, banking and lending counterparties on a daily basis. We believe our broker and banking counterparties are well-capitalized organizations and we attempt to manage our cash balances across these organizations to reduce our exposure to a single counterparty.

As of March 31, 2016, we had entered into repurchase agreements with 30 counterparties, 20 of which had outstanding balances at March 31, 2016, including two facilities that provide short-term financing for our residential mortgage loan and commercial real estate collateral with outstanding balances at March 31, 2016. In addition, we held both short- and long-term secured advances from the FHLB. As of March 31, 2016, we had a total consolidated debt-to-equity ratio of 3.9:1.0. The debt-to-equity ratio funding our RMBS AFS, residential mortgage loans held-for-sale, commercial real estate assets and Agency Derivatives only was 3.0:1.0. We believe the debt-to-equity ratio funding our RMBS AFS, residential mortgage loans held-for-sale, commercial real estate assets and Agency Derivatives is the most meaningful debt-to-equity measure as collateralized borrowings on residential mortgage loans held-for-investment in securitization trusts represents term financing with no stated maturity.

As of March 31, 2016, we had $754.8 million in cash and cash equivalents, approximately $102.4 million of unpledged Agency securities and derivatives and $59.4 million of unpledged non-Agency securities and retained interests from the Company's on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP. As a result, we had an overall estimated unused borrowing capacity on our unpledged RMBS and retained interests of approximately $99.0 million. We also had approximately $23.4 million of unpledged prime nonconforming residential mortgage loans, $11.0 million of unpledged CSL, and $29.6 million of unpledged Ginnie Mae buyout residential mortgage loans, and an overall estimated unused borrowing capacity on unpledged residential mortgage loans held-for-sale of approximately $47.8 million. As of March 31, 2016, we had approximately $43.8 million of unpledged mezzanine commercial real estate loans and $33.6 million of unpledged commercial real estate first mortgages, and an overall estimated unused borrowing capacity on unpledged commercial real estate assets of approximately $51.7 million. If borrowing rates and collateral requirements change in the near term, we believe we are subject to less earnings volatility than if we carried higher leverage.

We also monitor exposure to counterparties involved in our mortgage loan conduit and MSR businesses. In connection with securitization transactions and MSR assets, we are required to make certain representations and warranties to the investors in the RMBS we issue or the loans underlying the MSR we own. If the representations and warranties that we are required to make prove to be inaccurate, we may be obligated to repurchase certain mortgage loans, which may impact the profitability of these businesses. Although we obtain similar representations and warranties from the counterparty from which we acquired the relevant asset, if those representations and warranties do not directly mirror those we make to the investor, or if we are unable to enforce the representations and warranties against the counterparty for a variety of reasons, including the financial condition or insolvency of the counterparty, we may not be able to seek indemnification from our counterparties for any losses attributable to the breach.

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Summary of Results of Operations and Financial Condition

Our GAAP net loss was $88.9 million ($(0.25) per weighted share) for the three months ended March 31, 2016, as compared to GAAP net income of $94.8 million ($0.26 per weighted share) for the three months ended March 31, 2015.

With our accounting treatment for AFS securities, unrealized fluctuations in the market values of AFS securities, excluding Agency interest-only securities and GSE credit risk transfer securities, do not impact our GAAP net (loss) income or taxable income but are recognized on our condensed consolidated balance sheets as a change in stockholders' equity under "accumulated other comprehensive income." As a result of this fair value accounting through stockholders' equity, we expect our net (loss) income to have less significant fluctuations and result in less U.S. GAAP to taxable income timing differences, than if the portfolio were accounted for as trading instruments. For the three months ended March 31, 2016, net unrealized gains on AFS securities recognized as other comprehensive income, net of tax, were $21.3 million and for the three months ended March 31, 2015, net unrealized losses on AFS securities recognized as other comprehensive loss, net of tax, were $5.9 million. This, combined with our GAAP net (loss) income, resulted in comprehensive loss of $67.6 million for the three months ended March 31, 2016 as compared to comprehensive income of $88.9 million for the three months ended March 31, 2015.

On March 15, 2016, we declared a cash dividend of $0.23 per share. Our book value per common share for U.S. GAAP purposes was $9.70 at March 31, 2016, a decrease from $10.11 book value per common share at December 31, 2015. During this three month period, we recognized a GAAP net loss of $88.9 million and declared cash dividends of $79.9 million, driving the overall decrease in book value.

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The following tables present the components of our comprehensive (loss) income for the three months ended March 31, 2016 and 2015:

(in thousands, except share data)	Three Months Ended	
Income Statement Data:	March 31,	
	2016	2015
Interest income:	(unaudited)	
Available-for-sale securities	$79,428	$ 135,525
Trading securities	—	4,695
Residential mortgage loans held-for-sale	7,202	4,271
Residential mortgage loans held-for-investment in securitization trusts	32,771	18,237
Commercial real estate assets	11,072	44
Cash and cash equivalents	290	197
Total interest income	130,763	162,969
Interest expense:		
Repurchase agreements	16,029	20,565
Collateralized borrowings in securitization trusts	19,359	10,708
Federal Home Loan Bank advances	5,972	2,230
Total interest expense	41,360	33,503
Net interest income	89,403	129,466
Other-than-temporary impairment losses	(717)	(127)
Other income (loss):		
Gain on investment securities	29,474	129,457
Loss on interest rate swap and swaption agreements	(125,484)	(126,443)
Gain on other derivative instruments	16,015	2,967
Gain on residential mortgage loans held-for-sale	10,803	9,092
Servicing income	34,133	32,087
Loss on servicing asset	(101,440)	(52,403)
Other income (loss)	2,827	(1,857)
Total other loss	(133,672)	(7,100)
Expenses:		
Management fees	12,044	12,721
Securitization deal costs	3,732	2,611
Servicing expenses	7,861	6,716
Other operating expenses	14,856	16,055
Total expenses	38,493	38,103
(Loss) income before income taxes	(83,479)	84,136
Provision for (benefit from) income taxes	5,451	(10,657)
Net (loss) income	$(88,930)	$ 94,793
Basic and diluted (loss) earnings per weighted average common share	$(0.25)	$ 0.26
Dividends declared per common share	$0.23	$ 0.26
Basic and diluted weighted average number of shares of common stock outstanding	349,436,015	366,507,657

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(in thousands) Income Statement Data:	Three Months Ended March 31,	
	2016	2015
Comprehensive (loss) income:	(unaudited)	
Net (loss) income	$(88,930)	$94,793
Other comprehensive income (loss), net of tax:		
Unrealized gain (loss) on available-for-sale securities	21,345	(5,931)
Other comprehensive income (loss)	21,345	(5,931)
Comprehensive (loss) income	$(67,585)	$88,862

(in thousands) Balance Sheet Data:	March 31, 2016	December 31, 2015
	(unaudited)	
Available-for-sale securities	$9,584,454	$7,825,320
Total assets	$16,684,606	$14,575,772
Repurchase agreements	$6,189,852	$5,008,274
Federal Home Loan Bank advances	$4,000,000	$3,785,000
Total stockholders' equity	$3,370,691	$3,576,561

Results of Operations

The following analysis focuses on the results generated during the three months ended March 31, 2016 and 2015.

Interest Income and Average Portfolio Yield

The following table presents the components of interest income and average annualized net asset yield earned by investment type on our AFS securities, trading securities, residential mortgage loans held-for-sale, residential mortgage loans held-for-investment in securitization trusts, commercial real estate assets and Agency Derivatives for the three months ended March 31, 2016 and 2015:

	Three Months Ended March 31, 2016			Three Months Ended March 31, 2015		
(dollars in thousands)	Average Balance [1]	Interest Income	Net Asset Yield	Average Balance [1]	Interest Income	Net Asset Yield
Available-for-sale securities	$8,010,488	$79,428	4.0 %	$13,440,272	$135,525	4.0 %
Trading securities	—	—	— %	1,996,467	4,695	0.9 %
Residential mortgage loans held-for-sale	704,936	7,202	4.1 %	448,101	4,271	3.8 %
Residential mortgage loans held-for-investment in securitization trusts	3,374,502	32,771	3.9 %	1,873,476	18,237	3.9 %
Commercial real estate assets	691,158	11,072	6.4 %	2,531	44	7.0 %
	12,781,084	130,473	4.1 %	17,760,847	162,772	3.7 %
Agency derivatives [2]	134,360	5,914	17.6%	169,536	8,184	19.3%
Total	$12,915,444	$136,387	4.2 %	$17,930,383	$170,956	3.8 %

(1) Average balance represents average amortized cost on AFS, trading securities and Agency Derivatives and average unpaid principal balance, adjusted for purchase price changes, on residential mortgage loans held-for-sale, residential mortgage loans held-for-investment in securitization trusts and commercial real estate assets.

(2) Interest income on Agency Derivatives is included in gain on other derivative instruments on the condensed consolidated statements of comprehensive (loss) income.

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Total interest income, including interest income on Agency Derivatives, decreased from $171.0 million for the three months ended March 31, 2015 to $136.4 million for the same period in 2016, due primarily to sales of AFS securities, offset by purchases of residential mortgage loans held-for-sale, the completion of multiple securitization transactions in 2015 and 2016, and the growth of the commercial real estate portfolio.

Yields on AFS securities for the three months ended March 31, 2016 were consistent with those for the same period in 2015. We did not recognize any interest income on trading securities during the three months ended March 31, 2016 as we sold our trading security position during 2015. The increase in net yields on residential mortgage loans held-for-sale for the three months ended March 31, 2016, as compared to the same period in 2015, was due in part to generally higher interest rates during the three months ended March 31, 2016. Yields on residential mortgage loans held-for-investment in securitization trusts for the three months ended March 31, 2016 were consistent with those for the same period in 2015. The yield on commercial real estate assets for the three months ended March 31, 2015 represents interest income on one loan settled during the first quarter of 2015 which, as a result, is not comparable to the yield for the three months ended March 31, 2016. The decrease in net yields on Agency Derivatives for the three months ended March 31, 2016, as compared to the same period in 2015, was predominantly driven by faster expectation of prepayments on these interest-only securities.

The following table presents the components of the net yield earned by investment type on our RMBS AFS portfolio as a percentage of our average amortized cost of securities for the three months ended March 31, 2016 and 2015:

	Three Months Ended March 31, 2016			Three Months Ended March 31, 2015		
	Agency (1)	Non-Agency	Total	Agency (1)	Non-Agency	Total
Gross yield/stated coupon	4.5 %	3.5 %	4.3 %	4.5 %	3.1 %	4.3 %
Net (premium amortization) discount accretion	(1.4)%	4.8 %	(0.3)%	(1.3)%	4.8 %	(0.3)%
Net yield (2)	3.1 %	8.3 %	4.0 %	3.2 %	7.9 %	4.0 %

(1) Excludes Agency Derivatives. For the three months ended March 31, 2016, the average annualized net yield on total Agency RMBS, including Agency Derivatives, was 3.3%, compared to 3.5% for the same period in 2015.

(2) These yields have not been adjusted for cost of delay and cost to carry purchase premiums.

The following table provides the components of interest income and net asset yield by investment type on our RMBS AFS portfolio:

	Three Months Ended March 31, 2016			Three Months Ended March 31, 2015		
(dollars in thousands)	Agency (1)	Non-Agency	Total	Agency	Non-Agency	Total
Average amortized cost	$6,614,176	$1,396,312	$8,010,488	$11,140,030	$2,300,242	$13,440,272
Coupon interest	74,749	12,095	86,844	125,725	17,712	143,437
Net (premium amortization) discount accretion	(24,176)	16,760	(7,416)	(35,377)	27,465	(7,912)
Interest income	$50,573	$28,855	$79,428	$90,348	$45,177	$135,525
Net asset yield	3.1 %	8.3 %	4.0 %	3.2 %	7.9 %	4.0 %

(1) Excludes Agency Derivatives. For the three months ended March 31, 2016, the average annualized net yield on total Agency RMBS, including Agency Derivatives, was 3.3%, compared to 3.5% for the same period in 2015.

The decrease in net yields on Agency RMBS AFS for the three months ended March 31, 2016, as compared to the same period in 2015, was predominantly driven by faster prepayments on interest-only Agency RMBS. The increase in net yields on non-Agency RMBS for the three months ended March 31, 2016, as compared to the same period in 2015, was due to the sale of certain securities that we believe had reached maximum value.

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Interest Expense and the Cost of Funds

The following table presents the components of interest expense and average annualized cost of funds on borrowings incurred by investment type on our AFS securities, Agency Derivatives, trading securities, residential mortgage loans held-for-sale, residential mortgage loans held-for-investment in securitization trusts and commercial real estate assets for the three months ended March 31, 2016 and 2015:

(dollars in thousands)	Three Months Ended March 31, 2016			Three Months Ended March 31, 2015		
	Average Balance (1)	Interest Expense	Cost of Funds (2)	Average Balance (1)	Interest Expense	Cost of Funds (2)
Available-for-sale securities						
Agency (3)	$6,268,419	$10,698	0.7 %	$10,635,375	$10,843	0.4 %
Non-Agency	1,144,305	6,559	2.3 %	1,937,275	8,921	1.8 %
	7,412,724	17,257	0.9 %	12,572,650	19,764	0.6 %
Agency derivatives	116,202	406	1.4 %	135,202	337	1.0 %
Trading securities	—	—	— %	1,998,529	846	0.2 %
Residential mortgage loans held-for-sale	484,667	820	0.7 %	408,388	443	0.4 %
Residential mortgage loans held-for-investment in securitization trusts (4)	3,208,173	21,481	2.7 %	1,702,130	12,113	2.8 %
Commercial real estate assets	338,169	1,396	1.7 %	—	—	— %
Total	$11,559,935	$41,360	1.4 %	$16,816,899	$33,503	0.8 %

(1) Average balance represents average total repurchase agreements and FHLB advances on AFS securities, Agency Derivatives, trading securities, residential mortgage loans held-for-sale and commercial real estate assets, and average collateralized borrowings for residential mortgage loans held-for-investment in securitization trusts.

(2) Cost of funds by investment type is based on the underlying investment type of the asset assigned as collateral. Cost of funds does not include the accrual and settlement of interest associated with interest rate swaps. In accordance with U.S. GAAP, those costs are included in loss on interest rate swap and swaption agreements in the condensed consolidated statements of comprehensive (loss) income. For the three months ended March 31, 2016, our total average cost of funds on the assets assigned as collateral for repurchase agreements, FHLB advances and collateralized borrowings shown in the table above, including interest spread expense associated with interest rate swaps, was 1.7%, compared to 1.5% for the same period in 2015.

(3) Excludes Agency Derivatives. For the three months ended March 31, 2016, our average cost of funds on total Agency RMBS, including Agency Derivatives, was 0.7%, compared to