ANNALY CAPITAL MANAGEMENT INC
Form 10-Q
August 03, 2018

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED: JUNE 30, 2018

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 1-13447

ANNALY CAPITAL MANAGEMENT, INC.
(Exact Name of Registrant as Specified in its Charter)

MARYLAND (State or other jurisdiction of incorporation or organization)	22-3479661 (IRS Employer Identification No.)
1211 AVENUE OF THE AMERICAS NEW YORK, NY 10036 (Address of principal executive offices)	10036 (Zip Code)

(212) 696-0100
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all documents and reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes þ No

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 þ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the last practicable date:

Class	Outstanding at July 31, 2018
Common Stock, $.01 par value	1,166,658,384

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FORM 10-Q
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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(dollars in thousands, except per share data)

	June 30, 2018 (Unaudited)	December 31, 2017 [1]
ASSETS		
Cash and cash equivalents (including cash pledged as collateral of $1,042,671 and $579,213, respectively) [2]	$1,135,329	$706,589
Investments, at fair value:		
Agency mortgage-backed securities (including pledged assets of $80,997,975 and $83,628,132, respectively)	86,593,058	90,551,763
Credit risk transfer securities (including pledged assets of $417,403 and $363,944, respectively)	563,796	651,764
Non-Agency mortgage-backed securities (including pledged assets of $435,877 and $516,078, respectively) [3]	1,006,785	1,097,294
Residential mortgage loans (including pledged assets of $1,608,935 and $1,169,496, respectively) [4]	1,666,157	1,438,322
Mortgage servicing rights (including pledged assets of $4,164 and $5,224, respectively)	599,014	580,860
Commercial real estate debt investments (including pledged assets of $2,733,405 and $3,070,993, respectively) [5]	2,857,463	3,089,108
Commercial real estate debt and preferred equity, held for investment (including pledged assets of $652,897 and $520,329, respectively)	1,251,138	1,029,327
Loans held for sale, net	42,458	—
Investments in commercial real estate	477,887	485,953
Corporate debt (including pledged assets of $642,016 and $600,049, respectively)	1,256,276	1,011,275
Interest rate swaps, at fair value	82,458	30,272
Other derivatives, at fair value	129,680	283,613
Reverse repurchase agreements	259,762	—
Receivable for investments sold	21,728	1,232
Accrued interest and dividends receivable	323,769	323,526
Other assets	475,230	384,117
Goodwill	71,815	71,815
Intangible assets, net	19,194	23,220
Total assets	$98,832,997	$101,760,050
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Repurchase agreements	$75,760,655	$77,696,343
Other secured financing	3,760,487	3,837,528
Securitized debt of consolidated VIEs [6]	2,728,692	2,971,771
Mortgages payable	309,878	309,686
Interest rate swaps, at fair value	376,106	569,129
Other derivatives, at fair value	117,931	38,725
Dividends payable	349,300	347,876

Payable for investments purchased	1,108,834	656,581
Accrued interest payable	478,439	253,068
Accounts payable and other liabilities	68,819	207,770
Total liabilities	85,059,141	86,888,477
Stockholders' Equity:		
7.625% Series C Cumulative Redeemable Preferred Stock: 12,000,000 authorized, 7,000,000 and 12,000,0000 issued and outstanding, respectively	169,466	290,514
7.50% Series D Cumulative Redeemable Preferred Stock: 18,400,000 authorized, issued and outstanding	445,457	445,457
7.625% Series E Cumulative Redeemable Preferred Stock: 11,500,000 authorized, 0 and 11,500,000 issued and outstanding, respectively	—	287,500
6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock: 28,800,000 authorized, issued and outstanding	696,910	696,910
6.50% Series G Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock: 19,550,000 and 0 authorized, 17,000,000 and 0 issued, and outstanding, respectively	411,335	—
Common stock, par value $0.01 per share, 1,909,750,000 and 1,929,300,000 authorized, 1,164,333,831 and 1,159,585,078 issued and outstanding, respectively	11,643	11,596
Additional paid-in capital	17,268,596	17,221,265
Accumulated other comprehensive income (loss)	(3,434,447)	(1,126,020)
Accumulated deficit	(1,800,370)	(2,961,749)
Total stockholders' equity	13,768,590	14,865,473
Noncontrolling interest	5,266	6,100
Total equity	13,773,856	14,871,573
Total liabilities and equity	$98,832,997	$101,760,050

(1) Derived from the audited consolidated financial statements at December 31, 2017.

(2) Includes cash of consolidated Variable Interest Entities ("VIEs") of $32.4 million and $42.3 million at June 30, 2018 and December 31, 2017, respectively.

(3) Excludes $57.7 million and $66.3 million at June 30, 2018 and December 31, 2017, respectively, of non-Agency mortgage-backed securities in a consolidated VIE pledged as collateral and eliminated from the Company's Consolidated Statements of Financial Condition.

(4) Includes securitized residential mortgage loans transferred or pledged to a consolidated VIE carried at fair value of $523.0 million and $478.8 million at June 30, 2018 and December 31, 2017, respectively.

(5) Includes senior securitized commercial mortgage loans of consolidated VIEs carried at fair value of $2.5 billion and $2.8 billion at June 30, 2018 and December 31, 2017, respectively. Excludes $182.5 million at June 30, 2018 of commercial mortgage-backed securities in a consolidated VIE pledged as collateral and eliminated from the Company's Consolidated Statements of Financial Condition.

(6) Includes securitized debt of consolidated VIEs carried at fair value of $2.7 billion and $3.0 billion at June 30, 2018 and December 31, 2017, respectively.

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(dollars in thousands, except per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net interest income:				
Interest income	$776,806	$ 537,426	$1,656,293	$ 1,125,153
Interest expense	442,692	222,281	810,113	420,706
Net interest income	334,114	315,145	846,180	704,447
Realized and unrealized gains (losses):				
Net interest component of interest rate swaps	31,475	(96,470)	(16,685)	(200,626)
Realized gains (losses) on termination or maturity of interest rate swaps	—	(58)	834	(58)
Unrealized gains (losses) on interest rate swaps	343,475	(177,567)	1,320,760	(28,383)
Subtotal	374,950	(274,095)	1,304,909	(229,067)
Net gains (losses) on disposal of investments	(66,117)	(5,516)	(52,649)	(281)
Net gains (losses) on other derivatives	34,189	(14,423)	(12,956)	(14,104)
Net unrealized gains (losses) on instruments measured at fair value through earnings	(48,376)	16,240	(99,969)	39,923
Subtotal	(80,304)	(3,699)	(165,574)	25,538
Total realized and unrealized gains (losses)	294,646	(277,794)	1,139,335	(203,529)
Other income (loss):				
Other income (loss)	34,170	30,865	68,193	62,511
Total other income (loss)	34,170	30,865	68,193	62,511
General and administrative expenses:				
Compensation and management fee	45,579	38,938	90,108	78,200
Other general and administrative expenses	18,202	15,085	36,183	29,651
Total general and administrative expenses	63,781	54,023	126,291	107,851
Income (loss) before income taxes	599,149	14,193	1,927,417	455,578
Income taxes	3,262	(329)	3,826	648
Net income (loss)	595,887	14,522	1,923,591	454,930
Net income (loss) attributable to noncontrolling interest	(32)	(102)	(128)	(205)
Net income (loss) attributable to Annaly	595,919	14,624	1,923,719	455,135
Dividends on preferred stock	31,377	23,473	65,143	46,946
Net income (loss) available (related) to common stockholders	$564,542	$ (8,849)	$1,858,576	$ 408,189
Net income (loss) per share available (related) to common stockholders:				
Basic	$0.49	$ (0.01)	$1.60	$ 0.40
Diluted	$0.49	$ (0.01)	$1.60	$ 0.40
Weighted average number of common shares outstanding:				
Basic	1,160,436,717	1,019,000,817	1,160,029,575	1,018,971,942
Diluted	1,160,979,451	1,019,000,817	1,160,543,580	1,019,357,697
Dividends declared per share of common stock	$0.30	$ 0.30	$0.60	$ 0.60
Net income (loss)	$595,887	$ 14,522	$1,923,591	$ 454,930
Other comprehensive income (loss):				

Unrealized gains (losses) on available-for-sale securities	(505,130)	261,964	(2,384,609)	202,349
Reclassification adjustment for net (gains) losses included in net income (loss)	70,763	13,360	76,182	32,777
Other comprehensive income (loss)	(434,367)	275,324	(2,308,427)	235,126
Comprehensive income (loss)	161,520	289,846	(384,836)	690,056
Comprehensive income (loss) attributable to noncontrolling interest	(32)	(102)	(128)	(205)
Comprehensive income (loss) attributable to Annaly	161,552	289,948	(384,708)	690,261
Dividends on preferred stock	31,377	23,473	65,143	46,946
Comprehensive income (loss) attributable to common stockholders	$130,175	$ 266,475	$(449,851)	$643,315

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Six Months Ended June 30, 2018 and 2017
(dollars in thousands, except per share data)
(Unaudited)

	7.875% Series A Cumulative Redeemable Preferred Stock	7.625% Series C Cumulative Redeemable Preferred Stock	7.50% Series D Cumulative Redeemable Preferred Stock	7.625% Series E Cumulative Redeemable Preferred Stock	6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	6.50% Series G Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	Common stock par value	Additional paid-in capital	Accumulated other comprehensive income (loss)	Accumulate deficit
BALANCE, December 31, 2016	$177,088	$290,514	$445,457	$287,500	$—	$—	$10,189	$15,579,342	$(1,085,893)	$(3,136,01
Net income (loss) attributable to Annaly	—	—	—	—	—	—	—	—	—	455,135
Net income (loss) attributable to noncontrolling interest	—	—	—	—	—	—	—	—	—	—
Unrealized gains (losses) on available-for-sale securities	—	—	—	—	—	—	—	—	202,349	—
Reclassification adjustment for net (gains) losses included in net income (loss)	—	—	—	—	—	—	—	—	32,777	—
Stock compensation expense	—	—	—	—	—	—	—	1,149	—	—
Net proceeds from direct purchase and dividend reinvestment	—	—	—	—	—	—	1	1,269	—	—
Equity contributions from (distributions to) noncontrolling interest	—	—	—	—	—	—	—	—	—	—
	—	—	—	—	—	—	—	—	—	(7,296

Preferred Series A dividends, declared $0.984 per share										
Preferred Series C dividends, declared $0.953 per share	—	—	—	—	—	—	—	—	—	(11,438
Preferred Series D dividends, declared $0.938 per share	—	—	—	—	—	—	—	—	—	(17,250
Preferred Series E dividends, declared $0.953 per share	—	—	—	—	—	—	—	—	—	(10,962
Common dividends declared, $0.60 per share	—	—	—	—	—	—	—	—	—	(611,400
BALANCE, June 30, 2017	$177,088	$290,514	$445,457	$287,500	$—	$—	$10,190	$15,581,760	$(850,767)	$(3,339,228
BALANCE, December 31, 2017	$—	$290,514	$445,457	$287,500	$696,910	$—	$11,596	$17,221,265	$(1,126,020)	$(2,961,749
Net income (loss) attributable to Annaly	—	—	—	—	—	—	—	—	—	1,923,719
Net income (loss) attributable to noncontrolling interest	—	—	—	—	—	—	—	—	—	—
Unrealized gains (losses) on available-for-sale securities	—	—	—	—	—	—	—	—	(2,384,609)	—
Reclassification adjustment for net (gains) losses included in net income (loss)	—	—	—	—	—	—	—	—	76,182	—
Stock compensation expense	—	—	—	—	—	—	—	1,621	—	—
Redemption of Preferred Stock	—	(121,048)	—	(287,500)	—	—	—	(3,952)	—	—
Net proceeds from direct purchase and dividend reinvestment	—	—	—	—	—	—	1	1,545	—	—

Net proceeds from issuance of common stock	—	—	—	—	—	—	46	48,117	—	—
Net proceeds from issuance of preferred stock	—	—	—	—	—	411,335	—	—	—	—
Equity contributions from (distributions to) noncontrolling interest	—	—	—	—	—	—	—	—	—	—
Preferred Series C dividends, declared $0.953 per share [1]	—	—	—	—	—	—	—	—	—	(7,652
Preferred Series D dividends, declared $0.938 per share	—	—	—	—	—	—	—	—	—	(17,250
Preferred Series E dividends, declared $0.196 per share	—	—	—	—	—	—	—	—	—	(2,253
Preferred Series F dividends, declared $0.869 per share	—	—	—	—	—	—	—	—	—	(25,020
Preferred Series G dividends, declared $0.763 per share	—	—	—	—	—	—	—	—	—	(12,968
Common dividends declared, $0.60 per share	—	—	—	—	—	—	—	—	—	(697,197
BALANCE, June 30, 2018	$—	$169,466	$445,457	$—	$696,910	$411,335	$11,643	$17,268,596	$(3,434,447)	$(1,800,370

[1] Represents dividends declared per share for shares outstanding at June 30, 2018.

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(Unaudited)

	Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities:		
Net income (loss)	$1,923,591	$454,930
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Amortization of premiums and discounts of investments, net	289,693	450,031
Amortization of securitized debt premiums and discounts and deferred financing costs	(202)	789
Depreciation, amortization and other noncash expenses	12,907	14,846
Net (gains) losses on disposals of investments	52,649	281
Net (gains) losses on investments and derivatives	(1,207,835)	2,564
Income from unconsolidated joint ventures	5,067	1,651
Payments on purchases of loans held for sale	(110,350)	(69,093)
Proceeds of sales and repayments of loans held for sale	46,721	176,921
Net payments on derivatives	1,286,408	(797,580)
Net change in:		
Other assets	(98,456)	(65,053)
Accrued interest and dividends receivable	759	8,475
Accrued interest payable	225,371	22,707
Accounts payable and other liabilities	(136,273)	(88,818)
Net cash provided by (used in) operating activities	$2,290,050	$112,651
Cash flows from investing activities:		
Payments on purchases of Residential Investment Securities	$(7,309,307)	$(7,682,326)
Proceeds from sales of Residential Investment Securities	3,365,971	4,629,227
Principal payments on Residential Investment Securities	5,664,811	5,846,683
Purchase of MSRs	(381)	(10,000)
Payments on purchases of corporate debt	(464,496)	(252,452)
Principal payments on corporate debt	226,723	254,318
Originations and purchases of commercial real estate related assets	(358,179)	(169,001)
Proceeds from sales on commercial real estate related assets	28,079	11,960
Principal repayments on commercial real estate related assets	395,325	589,499
Proceeds from reverse repurchase agreements	41,248,786	38,955,000
Payments on reverse repurchase agreements	(41,508,548)	(38,955,000)
Distributions in excess of cumulative earnings from unconsolidated joint ventures	4,133	4,227
Payments on purchases of residential mortgage loans held for investment	(373,051)	(512,146)
Proceeds from repayments from residential mortgage loans held for investment	153,722	85,643
Payments on purchases of equity securities	—	(2,104)
Net cash provided by (used in) investing activities	$1,073,588	$2,793,528
Cash flows from financing activities:		
Proceeds from repurchase agreements and other secured financing	$2,727,664,289	$1,613,527,631
Principal payments on repurchase agreements and other secured financing	(2,729,676,977)	(1,616,345,278)
Proceeds from issuance of securitized debt	279,203	—

Principal repayments on securitized debt	(488,335)	(255,927)
Payment of deferred financing cost	—	(1,079)
Net proceeds from stock offerings, direct purchases and dividend reinvestments	461,044	1,270
Redemption of preferred stock	(412,500)	—
Principal payments on participation sold	—	(12,827)
Principal payments on mortgages payable	—	(36)
Net contributions/(distributions) from/(to) noncontrolling interests	(706)	(676)
Dividends paid	(760,916)	(658,311)
Net cash provided by (used in) financing activities	$(2,934,898)	$(3,745,233)
Net (decrease) increase in cash and cash equivalents	$428,740	$(839,054)
Cash and cash equivalents including cash pledged as collateral, beginning of period	706,589	1,539,746
Cash and cash equivalents including cash pledged as collateral, end of period	$1,135,329	$700,692
Supplemental disclosure of cash flow information:		
Interest received	$1,879,931	$1,582,650
Dividends received	$3,355	$2,511
Interest paid (excluding interest paid on interest rate swaps)	$740,186	$454,110
Net interest paid (received) on interest rate swaps	$(141,772)	$195,973
Taxes paid	$136	$1,336
Noncash investing activities:		
Receivable for investments sold	$21,728	$9,784
Payable for investments purchased	$1,108,834	$1,043,379
Net change in unrealized gains (losses) on available-for-sale securities, net of reclassification adjustment	$(2,308,427)	$235,126
Noncash financing activities:		
Dividends declared, not yet paid	$349,300	$305,709

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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1. DESCRIPTION OF BUSINESS

Annaly Capital Management, Inc. (the "Company" or "Annaly") is a Maryland corporation that commenced operations on February 18, 1997. The Company is a leading diversified capital manager that invests in and finances residential and commercial assets. The Company owns a portfolio of real estate related investments, including mortgage pass-through certificates, collateralized mortgage obligations, credit risk transfer ("CRT") securities, other securities representing interests in or obligations backed by pools of mortgage loans, residential mortgage loans, mortgage servicing rights ("MSRs"), commercial real estate assets and corporate debt. The Company's principal business objective is to generate net income for distribution to its stockholders and to preserve capital through prudent selection of investments and continuous management of its portfolio. The Company is externally managed by Annaly Management Company LLC (the "Manager").

The Company's investment groups are primarily comprised of the following:

- The Annaly Agency Group invests in Agency mortgage-backed securities collateralized by residential mortgages which are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae.
- The Annaly Residential Credit Group invests in non-Agency residential mortgage assets within the securitized product and residential mortgage loan markets.
- The Annaly Commercial Real Estate Group ("ACREG") originates and invests in commercial mortgage loans, securities and other commercial real estate debt and equity investments.
- The Annaly Middle Market Lending Group ("AMML") provides financing to private equity-backed middle market businesses across the capital structure.

The Company has elected to be taxed as a Real Estate Investment Trust ("REIT") as defined under the Internal Revenue Code of 1986, as amended, and regulations promulgated thereunder (the "Code").

Pending Acquisition of MTGE Investment Corp.

As previously disclosed in a Form 8-K filed with the SEC on May 3, 2018 (the "Merger 8-K"), on May 2, 2018, the Company, Mountain Merger Sub Corporation, a wholly-owned subsidiary of the Company ("Purchaser"), and MTGE Investment Corp. ("MTGE") entered into an agreement and plan of merger (the "Merger Agreement"), pursuant to which, subject to the terms and conditions contained therein, the Company agreed to acquire MTGE (the "MTGE Acquisition"), an externally managed hybrid mortgage REIT,

for aggregate consideration to MTGE common shareholders of approximately $900.0 million based on the closing price of the Company's common stock on April 30, 2018. Approximately 50% of such consideration will be payable in shares of the Company's common stock, and approximately 50% will be payable in cash. On May 16, 2018, Purchaser commenced an exchange offer (the "Offer") to purchase all of MTGE's issued and outstanding shares of common stock and, upon the closing of the Offer, subject to customary closing conditions as set forth in the Merger Agreement, MTGE will be merged with and into Purchaser (the "Merger"), with Purchaser surviving the Merger. In addition, as part of the MTGE Acquisition, each share of MTGE 8.125% Series A Cumulative Redeemable Preferred Stock, par value $0.01 per share (each, a "MTGE Preferred Share"), that is outstanding as of immediately prior to the completion of the MTGE Acquisition will be converted into one share of a newly-designated series of the Company's preferred stock, par value $0.01 per share, which the Company expects will be classified and designated as 8.125% Series H Cumulative Redeemable Preferred Stock, and which will have rights, preferences, privileges and voting powers substantially the same as a MTGE Preferred Share.

The closing of the MTGE Acquisition is subject to a number of conditions, including the receipt of specified regulatory approvals.

Prior to closing the MTGE Acquisition, MTGE will declare a prorated common dividend to its stockholders with a record date on the fourth business day prior to the completion of the Offer, and payable upon the date of the completion of the Offer. In addition, the Company expects to declare and pay a prorated common dividend to its stockholders, with a record date on the last business day prior to the completion of the Offer. Each of the dividends will be prorated based on the number of days that elapsed since the record date for the most recent quarterly dividend paid to MTGE's and the Company's stockholders, respectively, and the amount of such prior quarterly dividend, as applicable.

The MTGE Acquisition is expected to be completed during the third quarter of 2018.

For additional details regarding the terms and conditions of the Merger Agreement and related matters, please refer to the Merger Agreement and the Merger 8-K and the other documentation filed as exhibits thereto. Additional information regarding the transactions contemplated by the Merger Agreement, including associated risks, is contained in a registration statement on Form S-4 that the Company filed with the SEC in connection with the MTGE Acquisition.

2. BASIS OF PRESENTATION

The accompanying consolidated financial statements and related notes of the Company have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP").

The accompanying consolidated financial statements and related notes are unaudited and should be read in conjunction with the audited consolidated financial statements included in the Company's most recent annual report on Form 10-K. The consolidated financial information as of December 31, 2017 has been derived from audited consolidated financial statements included in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2017.

In the opinion of management, all normal, recurring adjustments have been included for a fair presentation of this interim financial information. Interim period operating results may not be indicative of the operating results for a full year. The Company reclassified previously presented financial information to conform to the current presentation.

3. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation – The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Variable Interest Entities – A VIE is defined as an entity in which equity investors (i) do not have the characteristics of a controlling financial interest, and/or (ii) do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. A variable interest is an investment or other interest that will absorb portions of a VIE's expected losses or receive portions of the entity's expected residual returns. The Company has evaluated all of its investments in legal entities in order to determine if they are variable interests in VIEs. A VIE is required to be consolidated by its primary beneficiary, which is defined as the party that (i) has the power to control the activities that most significantly impact the VIE's economic performance and (ii) has the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE.

To assess whether the Company has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, the Company considers all facts and circumstances, including the Company's role in establishing the VIE and the Company's ongoing rights and responsibilities. This assessment includes first, identifying the activities that most significantly impact the VIE's economic performance; and second, identifying which party, if any, has power over those activities. In general, the party that makes the most significant decisions affecting the VIE or has the right to unilaterally remove those decision makers

is deemed to have the power to direct the activities of the VIE.

To assess whether the Company has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, the Company applies significant judgment and considers all of its economic interests, including debt and equity investments and other arrangements deemed to be variable interests, both explicit and implicit, in the VIE. This assessment requires that the Company apply judgment in determining whether these interests, in the aggregate, are considered potentially significant to the VIE. Factors considered in assessing significance include: the design of the VIE, including its capitalization structure; subordination of interests; payment priority; and relative share of interests held across various classes within the VIE's capital structure.

The Company performs ongoing reassessments of whether changes in the facts and circumstances regarding the Company's involvement with a VIE causes the Company's consolidation conclusion to change.

Use of Estimates – The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and

disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Cash and Cash Equivalents – Cash and cash equivalents include cash on hand, cash held in money market funds on an overnight basis and cash pledged as collateral with counterparties. Cash deposited with clearing organizations is carried at cost, which approximates fair value. The Company also maintains collateral in the form of cash on margin with counterparties to its interest rate swaps and other derivatives. In accordance with a clearing organization's rulebook, the Company presents the fair value of centrally cleared interest rate swaps net of variation margin pledged under such transactions. At June 30, 2018, $1.2 billion of variation margin was reported as a reduction to interest rate swaps, at fair value. Arcola Securities, Inc. (formerly RCap Securities, Inc.), the Company's wholly-owned broker-dealer ("Arcola") is a member of various clearing organizations with which it maintains cash required to conduct its day-to-day clearance activities. Cash and securities deposited with clearing organizations and collateral held in the form of cash on margin with counterparties to the Company's interest rate swaps and other derivatives totaled $1.0 billion and $579.2 million at June 30, 2018 and December 31, 2017, respectively.

Fair Value Measurements – The Company reports various financial instruments at fair value. A complete discussion of the methodology utilized by the Company to estimate the fair

value of certain financial instruments is included in these Notes to Consolidated Financial Statements.

Revenue Recognition – The revenue recognition policy by asset class is discussed below.

Agency Mortgage-Backed Securities, Non-Agency Mortgage-Backed Securities and Credit Risk Transfer Securities – The Company invests in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of residential or multifamily mortgage loans and certificates guaranteed by the Government National Mortgage Association ("Ginnie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac") or the Federal National Mortgage Association ("Fannie Mae") (collectively, "Agency mortgage-backed securities"). These Agency mortgage-backed securities may include forward contracts for Agency mortgage-backed securities purchases or sales of a generic pool, on a to-be-announced basis ("TBA securities"). The Company also invests in CRT securities which are risk sharing instruments issued by Fannie Mae and Freddie Mac, and similarly structured transactions arranged by third party market participants. CRT securities are designed to synthetically transfer mortgage credit risk from Fannie Mae and Freddie Mac to private investors. Additionally, the Company invests in non-Agency mortgage-backed securities such as those issued in non-performing loan ("NPL") and re-performing loan ("RPL") securitizations.

Agency mortgage-backed securities, non-Agency mortgage-backed securities and CRT securities are referred to herein as "Residential Investment Securities." Although the Company generally intends to hold most of its Residential Investment Securities until maturity, it may, from time to time, sell any of its Residential Investment Securities as part of the overall management of its portfolio. Residential Investment Securities classified as available-for-sale are reported at fair value with unrealized gains and losses reported as a component of Other comprehensive income (loss) unless the Company has elected the fair value option, in which case the unrealized gains and losses on these financial instruments are recorded through earnings. The fair value of Residential Investment Securities classified as available-for-sale are estimated by management and are compared to independent sources for reasonableness. Residential Investment Securities transactions are recorded on trade date, including TBA securities that meet the regular-way securities scope exception from derivative accounting. Gains and losses on sales of Residential Investment Securities are recorded on trade date based on the specific identification method.

The Company elected the fair value option for interest-only mortgage-backed securities, non-Agency mortgage-backed securities, reverse mortgages and CRT securities as this election simplifies the accounting. Interest-only securities

and inverse interest-only securities are collectively referred to as "interest-only securities." These interest-only mortgage-backed securities represent the Company's right to receive a specified proportion of the contractual interest flows of specific mortgage-backed securities. Interest-only mortgage-backed securities, non-Agency mortgage-backed securities, reverse mortgages and CRT securities are measured at fair value with changes in fair value recorded as Net unrealized gains (losses) on instruments measured at fair value through earnings in the Company's Consolidated Statements of Comprehensive Income (Loss). The interest-only securities are included in Agency mortgage-backed securities at fair value on the accompanying Consolidated Statements of Financial Condition.
The Company recognizes coupon income, which is a component of interest income, based upon the outstanding principal amounts of the Residential Investment Securities and their contractual terms. In addition, the Company amortizes or accretes premiums or discounts into interest income for its Agency mortgage-backed securities (other than multifamily securities), taking into account estimates of future principal prepayments in the calculation of the effective yield. The Company recalculates the effective yield as differences between anticipated and actual prepayments occur. Using third-party model and market information to project future cash flows and expected remaining lives of securities, the effective interest rate determined for each security is applied as if it had been in place

from the date of the security's acquisition. The amortized cost of the security is then adjusted to the amount that would have existed had the new effective yield been applied since the acquisition date, which results in a cumulative premium amortization adjustment in each period. The adjustment to amortized cost is offset with a charge or credit to interest income. Changes in interest rates and other market factors will impact prepayment speed projections and the amount of premium amortization recognized in any given period.

Premiums or discounts associated with the purchase of Agency interest-only securities, reverse mortgages and residential credit securities are amortized or accreted into interest income based upon current expected future cash flows with any adjustment to yield made on a prospective basis.

The following table summarizes the interest income recognition methodology for Residential Investment Securities:

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	Interest Income Methodology
Agency	
Fixed-rate pass-through [1]	Effective yield [3]
Adjustable-rate pass-through [1]	Effective yield [3]
Multifamily [1]	Contractual Cash Flows
Collateralized Mortgage Obligation ("CMO") [1]	Effective yield [3]
Reverse mortgages [2]	Prospective
Interest-only [2]	Prospective
Residential Credit	
CRT [2]	Prospective
Alt-A [2]	Prospective
Prime [2]	Prospective
Subprime [2]	Prospective
NPL/RPL [2]	Prospective
Prime Jumbo [2]	Prospective
Prime Jumbo interest-only [2]	Prospective

(1) Changes in fair value are recognized in Other comprehensive income (loss) on the accompanying Consolidated Statements of Comprehensive Income (Loss).

(2) Changes in fair value are recognized in Net unrealized gains (losses) on instruments measured at fair value through earnings on the accompanying Consolidated Statements of Comprehensive Income (Loss).

(3) Effective yield is recalculated for differences between estimated and actual prepayments and the amortized cost is adjusted as if the new effective yield had been applied since inception.

Residential Mortgage Loans – The Company's residential mortgage loans are primarily comprised of performing adjustable-rate and fixed-rate whole loans. Additionally, the Company consolidates a collateralized financing entity that securitized prime adjustable-rate jumbo residential mortgage loans. The Company also consolidates a securitization trust in which it had purchased subordinated securities because it also has certain powers and rights to direct the activities of such trust. Please refer to the "Variable Interest Entities" Note for further information related to the Company's consolidated Residential Mortgage Loan Trusts. The Company made elections to account for the investments in residential mortgage loans held in its portfolio and in the securitization trusts at fair value as these elections simplify the accounting. Residential mortgage loans are recognized at fair value on the accompanying Consolidated Statements of Financial Condition. Changes in the estimated fair value are presented in Net unrealized gains (losses) on instruments measured at fair value through earnings in the Consolidated Statements of Comprehensive Income (Loss).

Premiums and discounts associated with the purchase of residential mortgage loans and with those held in the securitization trusts are primarily amortized or accreted into interest income over their estimated remaining lives using the effective interest rates inherent in the estimated cash flows from the mortgage loans. Amortization of premiums and accretion of discounts are presented in Interest income in the Consolidated Statements of Comprehensive Income (Loss).

There was no real estate acquired in settlement of residential mortgage loans at June 30, 2018 or December 31, 2017 other than real estate held by securitization trusts that the Company was required to consolidate. The Company would be considered to have received physical possession of

residential real estate property collateralizing a residential mortgage loan, so that the loan is derecognized and the real estate property would be recognized, if either (i) the Company obtains legal title to the residential real estate property upon completion of a foreclosure or (ii) the borrower conveys all interest in the residential real estate property to the Company to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement.

MSRs – MSRs represent the rights associated with servicing pools of residential mortgage loans, which the Company intends to hold as investments. The Company and its subsidiaries do not originate or directly service mortgage loans. Rather, these activities are carried out by duly licensed subservicers who perform substantially all servicing functions for the loans underlying the MSRs. The Company elected to account for all of its investments in MSRs at fair value. As such, they are recognized at fair value on the accompanying Consolidated Statements of Financial Condition with changes in the estimated fair value presented as a component of Net unrealized gains (losses) on instruments measured at fair value through earnings in the Consolidated Statements of Comprehensive Income (Loss). Servicing income, net of servicing expenses, is reported in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

Equity Securities – The Company may invest in equity securities that are not accounted for under the equity method or do not result in consolidation. These equity securities are required to be reported at fair value with unrealized gains and losses reported in the Consolidated Statements of Comprehensive Income (Loss) as Net unrealized gains (losses) on instruments measured at fair value through earnings, unless the securities do not have readily determinable fair values. For such equity securities without readily determinable fair values, the Company has elected to apply the measurement alternative and carry the securities at cost less impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer. For equity securities carried at fair value through earnings, dividends are recorded in earnings on the declaration date. Dividends from equity securities without readily determinable fair values are recognized as income when received to the extent they are distributed from net accumulated earnings.

Derivative Instruments – The Company may use a variety of derivative instruments to economically hedge some of its exposure to market risks, including interest rate and prepayment risk. These instruments include, but are not limited to, interest rate swaps, options to enter into interest rate swaps (“swaptions”), TBA securities without intent to accept delivery (“TBA derivatives”), options on TBA securities (“MBS options”), U.S. Treasury and Eurodollar futures contracts and certain forward purchase commitments. The Company may also enter into other types of mortgage derivatives such as interest-only securities, credit derivatives

referencing the commercial mortgage-backed securities index and synthetic total return swaps. Derivatives are accounted for in accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 815, Derivatives and Hedging, which requires recognition of all derivatives as either assets or liabilities at fair value in the Consolidated Statements of Financial Condition with changes in fair value recognized in the Consolidated Statements of Comprehensive Income (Loss). The changes in the estimated fair value are presented within Net gains (losses) on other derivatives with the exception of interest rate swaps which are separately presented. None of the Company's derivative transactions have been designated as hedging instruments for accounting purposes.

Some derivative agreements contain provisions that allow for netting or setting off by counterparty; however, the Company elected to present related assets and liabilities on a gross basis in the Consolidated Statements of Financial Condition.

Interest Rate Swap Agreements – Interest rate swap agreements are the primary instruments used to mitigate interest rate risk. In particular, the Company uses interest rate swap agreements to manage its exposure to changing interest rates on its repurchase agreements by economically hedging cash flows associated with these borrowings. Interest rate swap agreements may or may not be cleared through a derivatives clearing organization ("DCO"). Uncleared interest rate swaps are fair valued using internal pricing models and compared to the counterparty market values. Centrally cleared interest rate swaps are fair valued using the DCO's market values. We may use market agreed coupon ("MAC") interest rate swaps in which we may receive or make a payment at the time of entering into the swap to compensate for the out of the market nature of such interest rate swap. MAC interest rate swaps are also centrally cleared and fair valued using internal pricing models and compared to the DCO's market value.

Swaptions – Swaptions are purchased or sold to mitigate the potential impact of increases or decreases in interest rates. Interest rate swaptions provide the option to enter into an interest rate swap agreement for a predetermined notional amount, stated term and pay and receive interest rates in the future. They are not centrally cleared. The premium paid or received for swaptions is reported as an asset or liability in the Consolidated Statements of Financial Condition. If a swaption expires unexercised, the realized gain (loss) on the swaption would be equal to the premium received or paid. If the Company sells or exercises a swaption, the realized gain or loss on the swaption would be equal to the difference between the cash received or the fair value of the underlying interest rate swap received and the premium paid.

The fair value of swaptions is estimated using internal pricing models and compared to the counterparty market value.

TBA Dollar Rolls – TBA dollar roll transactions are accounted for as a series of derivative transactions. The fair value of TBA derivatives is based on methods similar to those used to value Agency mortgage-backed securities.

MBS Options – MBS options are generally options on TBA contracts, which help manage mortgage market risks and volatility while providing the potential to enhance returns. MBS options are over-the-counter traded instruments and those written on current-coupon mortgage-backed securities are typically the most liquid. MBS options are measured at fair value using internal pricing models and compared to the counterparty market value at the valuation date.
Futures Contracts – Futures contracts are derivatives that track the prices of specific assets or benchmark rates. Short sales of futures contracts help to mitigate the potential impact of changes in interest rates on the portfolio performance. The Company maintains margin accounts which are settled daily with Futures Commission Merchants ("FCMs"). The margin requirement varies based on the market value of the open positions and the equity retained in the account. Futures contracts are fair valued based on exchange pricing.
Forward Purchase Commitments – The Company may enter into forward purchase commitments with counterparties whereby the Company commits to purchasing residential mortgage loans at a particular price, provided the residential

mortgage loans close with the counterparties. The counterparties are required to deliver the committed loans on a “best efforts” basis.

Goodwill and Intangible Assets – The Company’s acquisitions are accounted for using the acquisition method if the acquisition is deemed to be a business. Under the acquisition method, net assets and results of operations of acquired companies are included in the consolidated financial statements from the date of acquisition. The purchase prices are allocated to the assets acquired, including identifiable intangible assets, and the liabilities assumed based on their estimated fair values at the date of acquisition. The excess of purchase price over the fair value of the net assets acquired is recognized as goodwill. Conversely, any excess of the fair value of the net assets acquired over the purchase price is recognized as a bargain purchase gain.

The Company tests goodwill for impairment on an annual basis and at interim periods when events or circumstances may make it more likely than not that an impairment has occurred. If a qualitative analysis indicates that there may be an impairment, a quantitative analysis is performed. The quantitative impairment test for goodwill utilizes a two-step approach, whereby the Company compares the carrying value of each identified reporting unit to its fair value. If the carrying value of the reporting unit is greater than its fair value, the second step is performed, where the implied fair value of goodwill is compared to its carrying value. The Company recognizes an impairment charge for the amount

by which the carrying amount of goodwill exceeds its fair value.
Finite life intangible assets are amortized over their expected useful lives.

Reverse Repurchase and Repurchase Agreements – The Company finances the acquisition of a significant portion of its assets with repurchase agreements. At the inception of each transaction, the Company assesses each of the specified criteria in ASC 860, Transfers and Servicing, and has determined that each of the financing agreements meet the specified criteria in this guidance.

The Company enters into reverse repurchase agreements to earn a yield on excess cash balances. The Company obtains collateral in connection with the reverse repurchase agreements in order to mitigate credit risk exposure to its counterparties.

Reverse repurchase agreements and repurchase agreements with the same counterparty and the same maturity are presented net in the Consolidated Statements of Financial Condition when the terms of the agreements meet the criteria to permit netting. The Company reports cash flows on repurchase agreements as financing activities and cash flows on reverse repurchase agreements as investing activities in the Consolidated Statements of Cash Flows.

Stock Based Compensation – The Company is required to measure and recognize in the consolidated financial statements the compensation cost relating to share-based payment transactions. The Company recognizes compensation expense on a straight-line basis over the requisite service period for the entire award.

Income Taxes – The Company has elected to be taxed as a REIT and intends to comply with the provisions of the Code, with respect thereto. Accordingly, the Company will not incur federal income tax to the extent of its distributions to stockholders and as long as certain asset, income and stock ownership tests are met. The Company and certain of its direct and indirect subsidiaries, including Arcola and certain subsidiaries of ACREG and Hatteras Financial Corp., have made separate joint elections to treat these subsidiaries as taxable REIT subsidiaries (“TRSs”). As such, each of these TRSs is taxable as a domestic C corporation and subject to federal, state and local income taxes based upon their taxable income.
The provisions of ASC 740, Income Taxes (“ASC 740”), clarify the accounting for uncertainty in income taxes recognized in financial statements and prescribe a recognition threshold and measurement attribute for uncertain tax positions taken or expected to be taken on a tax return. ASC 740 also requires that interest and penalties related to unrecognized tax benefits be recognized in the financial statements. The Company does not have any

unrecognized tax benefits that would affect its financial position. Thus, no accruals for penalties and interest were deemed necessary at June 30, 2018 and December 31, 2017.

Commercial Real Estate Investments

Commercial Real Estate Debt Investments – The Company’s commercial real estate debt investments are comprised of commercial mortgage-backed securities and loans held by consolidated collateralized financing entities. Certain commercial mortgage-backed securities are classified as available-for-sale and reported at fair value with unrealized gains and losses reported as a component of Other comprehensive income (loss). Management evaluates such commercial mortgage-backed securities for other-than-temporary impairment at least quarterly. The Company elected the fair value option on certain commercial mortgage-backed securities, including conduit commercial mortgage-backed securities, to simplify the accounting where the unrealized gains and losses on these financial instruments are recorded through earnings. See the “Commercial Real Estate Investments” Note for additional information regarding the consolidated collateralized financing entities.

Commercial Real Estate Loans and Preferred Equity Interests (collectively referred to as "CRE Debt and Preferred Equity Investments") – The Company's commercial real estate loans are comprised of fixed-rate and floating-rate loans. The Company designates loans as held for investment if it has the intent and ability to hold the loans until maturity or payoff. The difference between the principal amount of a loan and proceeds at acquisition is recorded as either a discount or premium. Commercial real estate loans that are designated as held for investment and are originated or purchased by the Company are carried at their outstanding principal balance, net of unamortized origination fees and costs, premiums or discounts, less an allowance for losses if necessary. Origination fees and costs, premiums or discounts are amortized into interest income over the life of the loan.

If the Company intends to sell or securitize the loans and the securitization vehicle is not expected to be consolidated, they are classified as held for sale. Commercial real estate loans that are designated as held for sale are carried at the lower of amortized cost or fair value and recorded as Loans held for sale, net in the accompanying Consolidated Statements of Financial Condition. Any origination fees and costs or purchase premiums or discounts are deferred and recognized upon sale. The Company determines the fair value of commercial real estate loans held for sale on an individual loan basis.

Preferred equity interests are designated as held for investment and are carried at their outstanding principal balance, net of unamortized origination fees and costs, premiums or discounts, less a reserve for estimated losses if necessary. See the "Commercial Real Estate Investments" Note for additional information.

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Investments in Commercial Real Estate – Investments in commercial real estate are carried at historical cost less accumulated depreciation. Historical cost includes all costs necessary to bring the asset to the condition and location necessary for its intended use, including financing during the construction period. Costs directly related to acquisitions deemed to be business combinations are expensed. Ordinary repairs and maintenance which are not reimbursed by tenants are expensed as incurred. Major replacements and improvements that extend the useful life of the asset are capitalized and depreciated over their useful life.
Investments in commercial real estate are depreciated using the straight-line method over the estimated useful lives of the assets, summarized as follows:

Category	Term
Building	30 - 40 years
Site improvements	1 - 28 years

The Company applies the equity method of accounting for its investments in joint ventures where it is not considered to have a controlling financial interest. Under the equity method of accounting, the Company will recognize its share of earnings or losses of the investee in the period in which they are reported by the investee. The Company also considers whether there are any indicators of other-than-temporary impairment of joint ventures accounted for under the equity method.

The Company evaluates whether real estate acquired in connection with a foreclosure or deed in lieu of foreclosure, herein collectively referred to as a foreclosure, ("REO") constitutes a business and whether business combination accounting is applicable. Upon foreclosure of a property, the excess of the carrying value of a loan, if any, over the estimated fair value of the property, less estimated costs to sell, is charged to provision for loan losses.

Investments in commercial real estate, including REO, that do not meet the criteria to be classified as held for sale are separately presented in the Consolidated Statements of Financial Condition as held for investment. Real estate held for sale is reported at the lower of its carrying value or its estimated fair value less estimated costs to sell. Once a property is determined to be held for sale, depreciation is no longer recorded.

The Company's real estate portfolio (REO and real estate held for investment) is reviewed on a quarterly basis, or more frequently as necessary, to assess whether there are any indicators that the value of its operating real estate may be impaired or that its carrying value may not be recoverable. A property's value is considered impaired if the Company's estimate of the aggregate future undiscounted cash flows to be generated by the property is less than the carrying value of the property. In conducting this review, the Company

considers U.S. macroeconomic factors, including real estate sector conditions, together with asset specific and other factors. To the extent impairment has occurred and is considered to be other than temporary, the loss will be measured as the excess of the carrying amount of the property over the calculated fair value of the property.

Revenue Recognition – Commercial Real Estate Investments – Interest income is accrued based on the outstanding principal amount of CRE Debt and Preferred Equity Investments and their contractual terms. Origination fees and costs, premiums or discounts associated with the purchase of CRE Debt and Preferred Equity Investments are amortized or accreted into interest income over the lives of the CRE Debt and Preferred Equity Investments using the effective interest method.

Corporate Debt
Corporate Loans – The Company's investments in corporate loans are designated as held for investment when the Company has the intent and ability to hold the investment until maturity or payoff. These investments are carried at their principal balance outstanding plus any premiums or discounts less allowances for loan losses. Interest income

from coupon payments is accrued based upon the outstanding principal amounts of the debt and its contractual terms. Premiums and discounts are amortized or accreted into interest income using the effective interest method. These investments typically take the form of senior secured loans primarily in first or second lien positions. The Company's senior secured loans generally have stated maturities of two to eight years. In connection with these senior secured loans the Company receives a security interest in certain of the assets of the borrower and such assets support repayment of such loans. Senior secured loans are generally exposed to less amount of credit risk than more junior loans given their seniority to scheduled principal and interest and priority of security in the assets of the borrower. To date, the significant majority of the Company's investments in corporate debt have been funded term loans versus bonds.

Corporate Debt Securities – The Company's investments in corporate debt that are debt securities are designated as held-to-maturity when the Company has the intent and ability to hold the investment until maturity. These investments are carried at their principal balance outstanding plus any premiums or discounts less other-than-temporary impairment. Interest income from coupon payments is accrued based upon the outstanding principal amounts of the debt and its contractual terms. Premiums and discounts are amortized or accreted into interest income using the interest method.

Impairment of Securities and Loans

Other - Than - Temporary Impairment – Management evaluates available-for-sale securities and held-to-maturity debt securities for other-than-temporary impairment at least

quarterly, and more frequently when economic or market conditions warrant such evaluation.

When the fair value of an available-for-sale security is less than its amortized cost, the security is considered impaired. For securities that are impaired, the Company determines if it (1) has the intent to sell the security, (2) is more likely than not that it will be required to sell the security before recovery of its amortized cost basis, or (3) does not expect to recover the entire amortized cost basis of the security. Further, the security is analyzed for credit loss (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, will then be recognized in the Consolidated Statements of Comprehensive Income (Loss), while the balance of losses related to other factors will be recognized as a component of Other comprehensive income (loss). If the fair value is less than the cost of a held-to-maturity security, the Company performs an analysis to determine whether it expects to recover the entire cost basis of the security. There was no other-than-temporary impairment recognized for the three and six months ended June 30, 2018 and 2017.

Allowance for Losses – The Company evaluates the need for a loss reserve on its CRE Debt and Preferred Equity Investments and its corporate loans. A provision for losses related to CRE Debt and Preferred Equity Investments and corporate loans, including those accounted for under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, may be established when it is probable the Company will not collect amounts contractually due or all amounts previously estimated to be collectible. Management assesses the credit quality of the portfolio and adequacy of loan loss reserves on a quarterly basis, or more frequently as necessary. Significant judgment is required in this analysis. Depending on the expected recovery of its investment, the Company considers the estimated net recoverable value of the CRE Debt and Preferred Equity Investments as well as other factors, including but not limited to the fair value of any collateral, the amount and the status of any senior debt, the prospects for the borrower and the competitive landscape where the borrower conducts business. To determine if loan loss allowances are required on investments in corporate debt, the Company reviews the monthly and/or quarterly financial statements of the borrowers, verifies loan compliance packages, if applicable, and analyzes current results relative to budgets and sensitivities performed at inception of the investment. Because these determinations are based upon projections of future economic events, which are inherently subjective, the amounts ultimately realized may differ materially from the carrying value as of the reporting date.
The Company may be exposed to various levels of credit risk depending on the nature of its investments and credit enhancements, if any, supporting its assets. The Company's core investment process includes procedures related to the initial approval and periodic monitoring of credit risk and

other risks associated with each investment. The Company's investment underwriting procedures include evaluation of the underlying borrowers' ability to manage and operate their respective properties or companies. Management reviews loan-to-value metrics at origination or acquisition of a new investment and if events occur that trigger re-evaluation by management.

Management generally reviews the most recent financial information produced by the borrower, which may include, but is not limited to, net operating income ("NOI"), debt service coverage ratios, property debt yields (net cash flow or NOI divided by the amount of outstanding indebtedness), loan per unit and rent rolls relating to each of the Company's CRE Debt and Preferred Equity Investments, and may consider other factors management deems important. Management also reviews market pricing to determine each borrower's ability to refinance their respective assets at the maturity of each loan, economic trends (both macro and those affecting the property specifically), and the supply and demand of competing projects in the sub-market in which each subject property is located. Management monitors the financial condition and operating results of its corporate borrowers and continually assesses the future outlook of the borrower's financial performance in light of industry developments, management changes and company-specific considerations.

The Company evaluates the need for a loss reserve on at least a quarterly basis through its surveillance review process. In connection with the surveillance review process, the Company's CRE Debt and Preferred Equity Investments are assigned an internal risk rating. The loan risk ratings conform to guidance provided by the Office of the Comptroller of the Currency for commercial real estate lending. The initial internal risk ratings ("Initial Ratings") are based on net operating income, debt service coverage ratios, property debt yields, loan per unit, rent rolls and other factors management deems important. A provision for loan losses may occur when it is probable the Company will not collect amounts contractually due or all amounts previously estimated to be collectible of the Company's CRE Debt and Preferred Equity Investments and based upon leverage and cash flow coverages of the borrowers' debt and operating obligations. The final internal risk ratings are influenced by other quantitative and qualitative factors that can result in an adjustment to the Initial Ratings, subject to review and approval by the respective committee. The internal risk rating categories include "Performing", "Performing - Closely Monitored", "Performing - Special Mention", "Substandard", "Doubtful" or "Loss". Performing loans meet all present contractual obligations. Performing - Closely Monitored loans meet all present contractual obligations, but are transitional or could be exhibiting some weakness in both leverage and liquidity. Performing - Special Mention loans exhibit potential weakness that deserves management's close attention and if uncorrected, may result in deterioration of repayment prospects. Substandard loans

are inadequately protected by sound worth and paying capacity of the obligor or of the collateral pledged with a distinct possibility that loss will be sustained if some of the deficiencies are not corrected. Doubtful loans are Substandard loans whereby collection of all contractual principal and interest is highly questionable or improbable. Loss loans are considered uncollectible.

Nonaccrual Status – If collection of a loan's principal or interest is in doubt or the loan is 90 days or more past due, interest income is not accrued. For nonaccrual status loans carried at fair value or held for sale, interest is not accrued, but is recognized on a cash basis. For nonaccrual status loans carried at amortized cost, if collection of principal is not in doubt, but collection of interest is in doubt, interest income is recognized on a cash basis. If collection of principal is in doubt, any interest received is applied against principal until collectability of the remaining balance is no longer in doubt; at that point, any interest income is recognized on a cash basis. Generally, a loan is returned to accrual status when the borrower has resumed paying the full amount of the scheduled contractual obligation, if all principal and interest amounts contractually due are reasonably assured of repayment within a reasonable period of time and there is a sustained period of repayment performance by the borrower. The Company did not have any impaired loans, nonaccrual loans, or loans in default as all of the loans were performing at June 30, 2018 and December 31, 2017. There were no allowances for loan losses at June 30, 2018 or December 31, 2017.

Broker Dealer Activities

Reverse Repurchase and Repurchase Agreements – Arcola enters into reverse repurchase agreements and repurchase agreements as part of its matched book trading activity. Reverse repurchase agreements are recorded on settlement date at the contractual amount and are collateralized by mortgage-backed or other securities. Margin calls are made by Arcola as necessary based on the daily valuation of the underlying collateral as compared to the contract price. Arcola generates income from the spread between what is earned on the reverse repurchase agreements and what is paid on the matched repurchase agreements. Arcola's policy is to obtain possession of collateral with a market value in excess of the principal amount loaned under reverse repurchase agreements. To ensure that the market value of the underlying collateral remains sufficient, collateral is valued daily, and Arcola will require counterparties to deposit additional collateral, when necessary. All reverse repurchase activities are transacted under master repurchase agreements that give Arcola the right, in the event of default, to liquidate collateral held and in some instances, to offset receivables and payables with the same counterparty. Substantially all of Arcola's reverse repurchase activity is with affiliated entities.

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Recent Accounting Pronouncements

The Company considers the applicability and impact of all Accounting Standards Updates ("ASUs"). ASUs not listed below were not applicable, not expected to have a significant

impact on the Company's consolidated financial statements when adopted, or did not have a significant impact on the Company's consolidated financial statements upon adoption.

Standard	Description	Effective Date	Effect on the Financial Statements or Other Significant Matters
Standards that are not yet adopted			
ASU 2016-13 Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments	This ASU updates the existing incurred loss model to a current expected credit loss ("CECL") model for financial assets and net investments in leases that are not accounted for at fair value through earnings. The amendments affect loans, held-to-maturity debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures and any other financial assets not excluded from the scope. There are also limited amendments to the impairment model for available-for-sale debt securities.	January 1, 2020 (early adoption permitted)	The Company currently plans to adopt the new standard on its effective date. While the Company is continuing to assess the impact the ASU will have on the consolidated financial statements, the measurement of expected credit losses under the CECL model will be based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amounts of the financial assets in scope of the model. The Company needs to complete the development of an appropriate allowance methodology, assess the impact on the consolidated financial statements and determine appropriate internal controls and financial statement disclosures. Further, based on the amended guidance for available-for-sale debt securities, the Company: • will be required to use an allowance approach to recognize credit impairment, with the allowance to be limited to the amount by which the security's fair value is less than its amortized cost basis; • may not consider the length of time fair value has been below amortized cost, and • may not consider recoveries of fair value after the balance sheet date when assessing whether a credit loss exists.

Standard	Description	Effective Date	Effect on the Financial Statements or Other Significant Matters
Standards that were adopted			
ASU 2017-01 Business Combinations	This update provides a screen to determine and a framework to evaluate when a set of assets and	January 1, 2018	The amendments are expected to result in fewer transactions being accounted for as business combinations.

(Topic 805): Clarifying the Definition of a Business	activities is a business.		
ASU 2016-15 Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments	This update provides specific guidance on certain cash flow classification issues, including classification of cash receipts and payments that have aspects of more than one class of cash flows. If cash flows cannot be separated by source or use, the appropriate classification should depend on the activity that is likely to be the predominant source or use of cash flows.	January 1, 2018	As a result of adopting this standard, the Company reclassified its cash flows on reverse repurchase and repurchase agreements entered into by Arcola from operating activities to investing and financing activities, respectively, in the Consolidated Statements of Cash Flows. The Company applied the retrospective transition method, which resulted in reclassification of comparative periods.

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4. FINANCIAL INSTRUMENTS

The following table presents characteristics for certain of the Company's financial instruments at June 30, 2018 and December 31, 2017.

Financial Instruments [1]

Balance Sheet Location	Form	Measurement Basis	June 30, 2018	December 31, 2017
Assets		(dollars in thousands)		
Agency mortgage-backed securities	Securities	Fair value, with unrealized gains (losses) through other comprehensive income	$85,593,158	$89,426,437
Agency mortgage-backed securities	Securities	Fair value, with unrealized gains (losses) through earnings	999,900	1,125,326
Total agency mortgage-backed securities			86,593,058	90,551,763
Credit risk transfer securities	Securities	Fair value, with unrealized gains (losses) through earnings	563,796	651,764
Non-agency mortgage-backed securities	Securities	Fair value, with unrealized gains (losses) through earnings	1,006,785	1,097,294
Residential mortgage loans	Loans	Fair value, with unrealized gains (losses) through earnings	1,666,157	1,438,322
Commercial real estate debt investments	Loans	Fair value, with unrealized gains (losses) through earnings	2,542,413	2,826,357
Commercial real estate debt investments	Securities	Fair value, with unrealized gains (losses) through other comprehensive income	204,319	244,636
Commercial real estate debt investments	Securities	Fair value, with unrealized gains (losses) through earnings	110,731	18,115
Total commercial real estate debt investments			2,857,463	3,089,108
Commercial real estate debt and preferred equity, held for investment	Loans	Amortized cost	1,251,138	1,029,327
Loans held for sale, net	Loans	Lower of amortized cost or fair value	42,458	—
Corporate debt	Loans	Amortized cost	1,256,276	1,011,275
Reverse repurchase agreements	Reverse repurchase agreements	Amortized cost	259,762	—
Liabilities				
Repurchase agreements	Repurchase agreements	Amortized cost	75,760,655	77,696,343
Other secured financing	Loans	Amortized cost	3,760,487	3,837,528
Securitized debt of consolidated VIEs	Securities	Fair value, with unrealized gains (losses) through earnings	2,728,692	2,971,771
Mortgages payable	Loans	Amortized cost	309,878	309,686

(1) Receivable for investments sold, Accrued interest and dividends receivable, Dividends payable, Payable for investments purchased and Accrued interest payable are accounted for at cost.

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5. RESIDENTIAL INVESTMENT SECURITIES

The following tables present the Company's Residential Investment Securities portfolio that was carried at their fair value at June 30, 2018 and December 31, 2017:

	June 30, 2018						
	Principal / Notional	Remaining Premium	Remaining Discount	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Agency	(dollars in thousands)						
Fixed-rate pass-through	$77,646,763	$4,442,937	$(1,556)	$82,088,144	$43,095	$(3,309,253)	$78,821,986
Adjustable-rate pass-through	5,847,337	277,049	(1,100)	6,123,286	10,478	(156,983)	5,976,781
Interest-only	6,537,051	1,273,388	—	1,273,388	2,447	(315,482)	960,353
Multifamily	816,976	4,872	(7,237)	814,611	1,065	(21,285)	794,391
Reverse mortgages	35,392	4,341	—	39,733	33	(219)	39,547
Total Agency investments	$90,883,519	$6,002,587	$(9,893)	$90,339,162	$57,118	$(3,803,222)	$86,593,058
Residential Credit							
CRT	$528,869	$18,234	$(1,079)	$546,024	$18,429	$(657)	$563,796
Alt-A	191,939	378	(32,845)	159,472	11,539	(89)	170,922
Prime	270,226	1,926	(23,127)	249,025	15,588	(122)	264,491
Subprime	449,644	1,827	(71,425)	380,046	46,511	(108)	426,449
NPL/RPL	3,431	—	(44)	3,387	60	—	3,447
Prime Jumbo (>= 2010 Vintage)	130,544	598	(4,113)	127,029	107	(2,995)	124,141
Prime Jumbo (>= 2010 Vintage) Interest-Only	910,065	13,731	—	13,731	3,616	(12)	17,335
Total residential credit investments	$2,484,718	$36,694	$(132,633)	$1,478,714	$95,850	$(3,983)	$1,570,581
Total Residential Investment Securities	$93,368,237	$6,039,281	$(142,526)	$91,817,876	$152,968	$(3,807,205)	$88,163,639

	December 31, 2017						
	Principal / Notional	Remaining Premium	Remaining Discount	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Agency	(dollars in thousands)						
Fixed-rate pass-through	$78,509,335	$4,514,815	$(1,750)	$83,022,400	$140,115	$(1,178,673)	$81,983,842
Adjustable-rate pass-through	6,760,991	277,212	(1,952)	7,036,251	15,776	(103,121)	6,948,906
Interest-only	6,804,715	1,326,761	—	1,326,761	1,863	(242,862)	1,085,762
Multifamily	490,753	5,038	(341)	495,450	84	(1,845)	493,689
Reverse mortgages	35,000	4,527	—	39,527	37	—	39,564
Total Agency investments	$92,600,794	$6,128,353	$(4,043)	$91,920,389	$157,875	$(1,526,501)	$90,551,763
Residential Credit							
CRT	$593,027	$25,463	$(3,456)	$615,034	$36,730	$—	$651,764
Alt-A	204,213	499	(34,000)	170,712	13,976	(802)	183,886
Prime	197,756	358	(24,158)	173,956	18,804	—	192,760
Subprime	554,470	2,037	(78,561)	477,946	56,024	(90)	533,880
NPL/RPL	42,585	14	(117)	42,482	506	—	42,988
	130,025	627	(3,956)	126,696	1,038	(1,112)	126,622

Prime Jumbo (>= 2010 Vintage)							
Prime Jumbo (>= 2010 Vintage) Interest-Only	989,052	15,287	—	15,287	1,871	—	17,158
Total residential credit investments	$2,711,128	$44,285	$(144,248)	$1,622,113	$128,949	$(2,004)	$1,749,058
Total Residential Investment Securities	$95,311,922	$6,172,638	$(148,291)	$93,542,502	$286,824	$(1,528,505)	$92,300,821

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The following table presents the Company's Agency mortgage-backed securities portfolio concentration by issuing Agency at June 30, 2018 and December 31, 2017:

Investment Type	June 30, 2018	December 31, 2017
	(dollars in thousands)	
Fannie Mae	$61,012,468	$63,361,415
Freddie Mac	25,490,083	27,091,978
Ginnie Mae	90,507	98,370
Total	$86,593,058	$90,551,763

Actual maturities of the Company's Residential Investment Securities portfolio are generally shorter than stated contractual maturities because actual maturities of the portfolio are generally affected by periodic payments and prepayments of principal on underlying mortgages.

The following table summarizes the Company's available-for-sale Residential Investment Securities at June 30, 2018 and December 31, 2017, according to their estimated weighted average life classifications:

Weighted Average Life	June 30, 2018		December 31, 2017	
	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost
	(dollars in thousands)			
Less than one year	$6,224	$6,304	$471,977	$476,538
Greater than one year through five years	10,712,094	10,950,207	13,838,890	13,925,749
Greater than five years through ten years	76,435,458	79,830,605	77,273,833	78,431,852
Greater than ten years	1,009,863	1,030,760	716,121	708,363
Total	$88,163,639	$91,817,876	$92,300,821	$93,542,502

The weighted average lives of the Agency mortgage-backed securities at June 30, 2018 and December 31, 2017 in the table above are based upon projected principal prepayment rates. The actual weighted average lives of the Agency mortgage-backed securities could be longer or shorter than projected.

The following table presents the gross unrealized losses and estimated fair value of the Company's Agency mortgage-backed securities, accounted for as available-for-sale where the fair value option has not been elected, by length of time that such securities have been in a continuous unrealized loss position at June 30, 2018 and December 31, 2017.

	June 30, 2018			December 31, 2017		
	Estimated Fair Value [1]	Gross Unrealized Losses [1]	Number of Securities [1]	Estimated Fair Value [1]	Gross Unrealized Losses [1]	Number of Securities [1]
	(dollars in thousands)					
Less than 12 Months	$43,845,297	$(1,386,377)	1,360	$39,878,158	$(272,234)	1,114
12 Months or More	38,372,979	(2,101,144)	1,102	39,491,238	(1,011,405)	911
Total	$82,218,276	$(3,487,521)	2,462	$79,369,396	$(1,283,639)	2,025

[1] Excludes interest-only mortgage-backed securities and reverse mortgages.

The decline in value of these securities is solely due to market conditions and not the quality of the assets. Substantially all of the Agency mortgage-backed securities are “AAA” rated or carry an implied “AAA” rating. The investments are not considered to be other-than-temporarily impaired because the Company currently has the ability and intent to hold the investments to maturity or for a period of time sufficient for a forecasted market price recovery up to or beyond the cost of the investments, and it is not more likely than not that the Company will be required to sell the investments before recovery of the amortized cost bases, which may be maturity.

The Company is also guaranteed payment of the principal amount of the securities by the respective issuing government agency.

During the three and six months ended June 30, 2018, the Company disposed of $2.9 billion and $3.4 billion of Residential Investment Securities, resulting in net realized (losses) of ($63.1) million and ($50.0) million, respectively. During the three and six months ended June 30, 2017, the Company disposed of $2.5 billion and $4.6 billion of Residential Investment Securities, resulting in net realized losses of ($5.2) million and ($4.0) million, respectively.

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6. RESIDENTIAL MORTGAGE LOANS

The following table presents the fair value and the unpaid principal balances of the residential mortgage loan portfolio at June 30, 2018 and December 31, 2017:

	June 30, 2018	December 31, 2017
	(dollars in thousands)	
Fair value	$1,666,157	$ 1,438,322
Unpaid principal balance	$1,658,358	$ 1,419,807

The following table provides information regarding the line items and amounts recognized in the Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2018 and 2017 for these investments:

	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	(dollars in thousands)			
Net interest income	$15,784	$7,120	$29,279	$10,709
Net gains (losses) on disposal of investments	(3,191)	(321)	(4,949)	(1,314)
Net unrealized gains (losses) on instruments measured at fair value through earnings	(1,305)	5,310	(11,169)	6,125
Total included in net income (loss)	$11,288	$12,109	$13,161	$15,520

The following table provides the geographic concentrations based on the unpaid principal balances at June 30, 2018 and December 31, 2017, for the residential mortgage loans, including loans held in securitization trusts:

Geographic Concentrations of Residential Mortgage Loans

June 30, 2018		December 31, 2017	
Property Location	% of Balance	Property Location	% of Balance
California	53.1 %	California	49.8 %
New York	9.3 %	Florida	9.3 %
Florida	7.2 %	New York	7.1 %
All other (none individually greater than 5%)	30.4 %	All other (none individually greater than 5%)	33.8 %
Total	100.0 %	Total	100.0 %

The following table provides additional data on the Company's residential mortgage loans, including loans held in securitization trusts, at June 30, 2018 and December 31, 2017:

June 30, 2018		December 31, 2017	
Portfolio Range	Portfolio Weighted Average	Portfolio Range	Portfolio Weighted Average
(dollars in thousands)		(dollars in thousands)	

Unpaid principal balance	$0 - $3,635	$539	$1 - $3,663	$514
Interest rate	2.00% - 7.50%	4.53%	1.63% - 7.50%	4.25%
Maturity	1/1/2028 - 6/1/2058	2/5/2044	1/1/2028 - 5/1/2057	2/1/2043
FICO score at loan origination	498 - 823	750	468 - 823	748
Loan-to-value ratio at loan origination	11% - 100%	67%	11% - 100%	68%

At June 30, 2018 and December 31, 2017, approximately 66% and 78%, respectively, of the carrying value of the Company's residential mortgage loans, including loans held in securitization trusts, were adjustable-rate.

7. MORTGAGE SERVICING RIGHTS

The Company invests in MSRs and has elected to carry them at fair value. The following table presents activity related to MSRs for the three and six months ended June 30, 2018 and 2017:

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	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	(dollars in thousands)			
Fair value, beginning of period	$596,378	$632,166	$580,860	$652,216
Purchases [1]	—	(210)	—	3
Change in fair value due to:				
Changes in valuation inputs or assumptions [2]	22,578	(9,205)	59,252	(15,438)
Other changes, including realization of expected cash flows	(19,942)	(17,098)	(41,098)	(31,128)
Fair value, end of period	$599,014	$605,653	$599,014	$605,653

(1) Includes adjustments to original purchase price from early payoffs, defaults, or loans that were delivered but were deemed to be not acceptable.

(2) Principally represents changes in discount rates and prepayment speed inputs used in valuation model, primarily due to changes in interest rates.

For the three and six months ended June 30, 2018, the Company recognized $27.6 million and $56.2 million, respectively, and for the three and six months ended June 30, 2017, the Company recognized $33.3 million and $67.8 million, respectively,

of net servicing income from MSRs in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

8. COMMERCIAL REAL ESTATE INVESTMENTS

CRE Debt and Preferred Equity Investments

At June 30, 2018 and December 31, 2017, commercial real estate investments held for investment were comprised of the following:

	June 30, 2018			December 31, 2017		
	Outstanding Principal	Carrying Value [1]	Percentage of Loan Portfolio [2]	Outstanding Principal	Carrying Value [1]	Percentage of Loan Portfolio [2]
	(dollars in thousands)					
Senior mortgages	$887,728	$882,570	70.6 %	$629,143	$625,900	60.9 %
Mezzanine loans	360,095	359,574	28.7 %	395,015	394,442	38.2 %
Preferred equity	9,000	8,994	0.7 %	9,000	8,985	0.9 %
Total	$1,256,823	$1,251,138	100.0 %	$1,033,158	$1,029,327	100.0 %

(1) Carrying value includes unamortized origination fees of $5.7 million and $3.8 million at June 30, 2018 and December 31, 2017, respectively.

(2) Based on outstanding principal.

	June 30, 2018			
	Senior Mortgages	Mezzanine Loans	Preferred Equity	Total

	(dollars in thousands)			
Beginning balance (January 1, 2018)	$625,900	$394,442	$ 8,985	$1,029,327
Originations & advances (principal)	286,017	24,193	—	310,210
Principal payments	(27,432)	(59,113)	—	(86,545)
Net (increase) decrease in origination fees	(3,130)	(147)	—	(3,277)
Amortization of net origination fees	1,215	199	9	1,423
Net carrying value (June 30, 2018)	$882,570	$359,574	$ 8,994	$1,251,138

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	December 31, 2017			
	Senior Mortgages	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)			
Beginning balance (January 1, 2017)	$510,071	$451,467	$ 8,967	$970,505
Originations & advances (principal)	338,242	69,121	—	407,363
Principal payments	(221,421)	(127,799)	—	(349,220)
Amortization & accretion of (premium) discounts	(44)	28	—	(16)
Net (increase) decrease in origination fees	(3,317)	(605)	—	(3,922)
Amortization of net origination fees	2,369	2,230	18	4,617
Net carrying value (December 31, 2017)	$625,900	$394,442	$ 8,985	$1,029,327

Internal CRE Debt and Preferred Equity Investment Ratings

The Company’s internal loan risk ratings are based on the guidance provided by the Office of the Comptroller of the Currency for commercial real estate lending. The Company’s internal risk rating categories include “Performing”, “Performing - Closely Monitored”, “Performing - Special Mention”, “Substandard”, “Doubtful” or “Loss”. Performing loans meet all present contractual obligations. Performing - Closely Monitored loans meet all present contractual obligations, but are transitional or could be exhibiting some weakness in both leverage and liquidity. Performing - Special Mention loans meet all present contractual obligations, but

exhibit potential weakness that deserves management’s close attention and if uncorrected, may result in deterioration of repayment prospects. Substandard loans are inadequately protected by sound worth and paying capacity of the obligor or of the collateral pledged with a distinct possibility that loss will be sustained if some of the deficiencies are not corrected. Doubtful loans are Substandard loans whereby collection of all contractual principal and interest is highly questionable or improbable. Loss loans are considered uncollectible. The Company did not have any impaired loans, nonaccrual loans, or loans in default in the commercial loans portfolio as all of the loans were performing at June 30, 2018 and December 31, 2017. As such, no provision for loan losses was deemed necessary at June 30, 2018 and December 31, 2017.

	June 30, 2018								
		Percentage of CRE Debt and Preferred Equity Portfolio	Internal Ratings						
Investment Type	Outstanding Principal		Performing	Performing - Closely Monitored	Performing - Special Mention	Substandard [1]	Doubtful	Loss	Total
	(dollars in thousands)								
Senior mortgages	$887,728	70.6 %	$513,610	$272,928	$36,800	$64,390	$—	$—	$887,728
Mezzanine loans	360,095	28.7 %	160,173	51,608	111,711	36,603	—	—	360,095
Preferred equity	9,000	0.7 %	—	—	9,000	—	—	—	9,000
Total	$1,256,823	100.0 %	$673,783	$324,536	$157,511	$100,993	$—	$—	$1,256,823

	December 31, 2017								
	Outstanding Principal	Percentage of CRE Debt and Preferred	Internal Ratings						
Investment Type			Performing	Performing - Closely Monitored	Performing - Special Mention	Substandard [1]	Doubtful	Loss	Total

	Equity Portfolio (dollars in thousands)									
Senior mortgages	$629,143	60.9	%	$409,878	$115,075	$36,800	$67,390	$—	$—	$629,143
Mezzanine loans	395,015	38.2	%	206,169	66,498	122,348	—	—	—	395,015
Preferred equity	9,000	0.9	%	—	—	9,000	—	—	—	9,000
Total	$1,033,158	100.0	%	$616,047	$181,573	$168,148	$67,390	$—	$—	$1,033,158

(1) The Company rated two loans as Substandard as of June 30, 2018. The Company evaluated whether an impairment exists and determined in each case that, based on quantitative and qualitative factors, the Company expects repayment of contractual amounts due.

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At June 30, 2018 and December 31, 2017, approximately 85% of the carrying value of the Company's CRE Debt and Preferred Equity Investments, excluding loans held for sale, was comprised of floating-rate debt investments.

Investments in Commercial Real Estate

There were no acquisitions of real estate holdings during the three and six months ended June 30, 2018 and 2017. The Company sold one of its wholly-owned triple net leased properties during the six months ended June 30, 2017 for $12.0 million and recognized a gain on sale of $5.1 million.

The weighted average amortization period for intangible assets and liabilities at June 30, 2018 is 4.4 years. Above market leases and leasehold intangible assets are included in Intangible assets, net and below market leases are included in Accounts payable and other liabilities in the Consolidated Statements of Financial Condition.

	June 30, 2018	December 31, 2017
	(dollars in thousands)	
Real estate held for investment, at amortized cost		
Land	$111,012	$ 111,012
Buildings and improvements	331,879	330,959
Subtotal	442,891	441,971
Less: accumulated depreciation	(56,315)	(48,920)
Total real estate held for investment, at amortized cost, net	386,576	393,051
Equity in unconsolidated joint ventures	91,311	92,902
Investments in commercial real estate, net	$477,887	$ 485,953

Depreciation expense was $3.6 million and $7.4 million for the three and six months ended June 30, 2018, respectively. Depreciation expense was $3.9 million and $7.8 million for the three and six months ended June 30, 2017, respectively.
Depreciation expense is included in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

Rental Income

The minimum rental amounts due under leases are generally either subject to scheduled fixed increases or adjustments. The leases generally also require that the tenants reimburse the Company for certain operating costs.

Approximate future minimum rents to be received over the next five years and thereafter for non-cancelable operating leases in effect at June 30, 2018 for consolidated investments in real estate are as follows:

	June 30, 2018

	(dollars in thousands)
2018 (remaining)	$ 14,895
2019	27,384
2020	22,653
2021	18,271
2022	13,278
Later years	22,002
Total	$ 118,483

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Mortgage loans payable at June 30, 2018 and December 31, 2017, were as follows:

June 30, 2018

Property	Mortgage Carrying Value	Mortgage Principal	Interest Rate	Fixed/Floating Rate	Maturity Date	Priority
(dollars in thousands)						
Joint Ventures	$286,546	$289,125	4.03% - 4.61%	Fixed	2024 and 2025	First liens
Tennessee	12,311	12,350	4.01%	Fixed	9/6/2019	First liens
Virginia	11,021	11,025	3.58%	Fixed	6/6/2019	First liens
Total	$309,878	$312,500				

December 31, 2017

Property	Mortgage Carrying Value	Mortgage Principal	Interest Rate	Fixed/Floating Rate	Maturity Date	Priority
(dollars in thousands)						
Joint Ventures	$286,373	$289,125	4.03% - 4.61%	Fixed	2024 and 2025	First liens
Tennessee	12,294	12,350	4.01%	Fixed	9/6/2019	First liens
Virginia	11,019	11,025	3.58%	Fixed	6/6/2019	First liens
Total	$309,686	$312,500				

The following table details future mortgage loan principal payments at June 30, 2018:

	Mortgage Loan Principal Payments (dollars in thousands)
2018 (remaining)	$ —
2019	23,375
2020	—
2021	—
2022	—
Later years	289,125
Total	$ 312,500

On December 11, 2015, the Company originated a $335.0 million recapitalization financing with respect to eight class A/B office properties in Orange County, California. The Company previously classified the senior mortgage loan as held for sale.

During the six months ended June 30, 2017, the Company sold the remaining balance of $115.0 million ($114.4 million, net of origination fees) of the senior loan to unrelated third parties at carrying value. Accordingly, no gain or loss was recorded in connection with the sale.

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9. CORPORATE DEBT

The Company invests in corporate loans and corporate debt securities through AMML. The industry and rate sensitivity dispersion of the portfolio at June 30, 2018 and December 31, 2017 are as follows:

	Industry Dispersion					
	June 30, 2018			December 31, 2017		
	Fixed Rate	Floating Rate	Total	Fixed Rate	Floating Rate	Total
	(dollars in thousands)					
Aircraft and Parts	$—	$38,022	$38,022	$—	$34,814	$34,814
Coating, Engraving and Allied Services	—	60,049	60,049	—	64,034	64,034
Computer Programming, Data Processing & Other Computer Related Services	—	212,750	212,750	—	209,624	209,624
Drugs	—	38,730	38,730	—	38,708	38,708
Electrical Work	—	39,457	39,457	—	—	—
Electronic Components & Accessories	—	23,995	23,995	—	23,916	23,916
Engineering, Architectural & Surveying	—	10,635	10,635	—	—	—
Groceries and Related Products	—	14,745	14,745	—	14,794	14,794
Grocery Stores	—	23,486	23,486	—	23,531	23,531
Home Health Care Services	—	—	—	—	23,779	23,779
Insurance Agents, Brokers and Services	—	49,480	49,480	—	28,872	28,872
Mailing, Reproduction, Commercial Art and Photography, and Stenographic	—	14,863	14,863	—	—	—
Management and Public Relations Services	—	210,511	210,511	—	94,871	94,871
Medical and Dental Laboratories	—	26,904	26,904	—	26,956	26,956
Miscellaneous Business Services	—	19,677	19,677	—	19,723	19,723
Miscellaneous Equipment Rental and Leasing	—	49,375	49,375	—	49,129	49,129
Miscellaneous Health and Allied Services, not elsewhere classified	—	54,196	54,196	—	25,963	25,963
Miscellaneous Nonmetallic Minerals, except Fuels	—	—	—	—	25,992	25,992
Miscellaneous Plastic Products	—	9,937	9,937	—	9,879	9,879
Motor Vehicles and Motor Vehicle Equipment	—	17,138	17,138	—	—	—
Motor Vehicles and Motor Vehicle Parts and Supplies	—	23,546	23,546	—	12,212	12,212
Offices and Clinics of Doctors of Medicine	—	97,722	97,722	—	60,000	60,000
Offices and Clinics of Other Health Practitioners	—	20,053	20,053	—	18,979	18,979
Public Warehousing and Storage	—	55,057	55,057	—	48,890	48,890
Research, Development and Testing Services	—	33,282	33,282	—	33,155	33,155
Schools and Educational Services, not elsewhere classified	—	19,806	19,806	—	20,625	20,625
Services Allied with the Exchange of Securities	—	14,909	14,909	—	13,960	13,960
Surgical, Medical, and Dental Instruments and Supplies	—	16,658	16,658	—	29,687	29,687
Telephone Communications	—	61,293	61,293	—	59,182	59,182
Total	$—	$1,256,276	$1,256,276	$—	$1,011,275	$1,011,275

The table below reflects the Company's aggregate positions by their respective place in the capital structure of the borrowers at June 30, 2018 and December 31, 2017.

June 30, 2018	December 31, 2017

	(dollars in thousands)	
First lien loans	$753,373	$ 582,724
Second lien loans	502,903	428,551
Total	$1,256,276	$ 1,011,275

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10. VARIABLE INTEREST ENTITIES

In February 2015, the Company purchased the junior-most tranche, Class C Certificate of the Freddie Mac securitization, FREMF Mortgage Trust 2015-KLSF ("FREMF 2015-KLSF") for $102.1 million. The underlying portfolio is a pool of 11 floating rate multifamily mortgage loans with a cut-off principal balance of $1.4 billion. The Company is required to consolidate the FREMF 2015-KLSF Trust's assets and liabilities of $547.0 million and $507.0 million, respectively, at June 30, 2018.

In April 2015, the Company purchased the junior-most tranche, Class C Certificate of the Freddie Mac securitization, FREMF Mortgage Trust 2015-KF07 ("FREMF 2015-KF07") for $89.4 million. The underlying portfolio is a pool of 40 floating rate multifamily mortgage loans with a cut-off principal balance of $1.2 billion. The Company is required to consolidate the FREMF 2015-KF07 Trust's assets and liabilities of $484.9 million and $449.7 million, respectively, at June 30, 2018.

In February 2016, the Company purchased the junior- most tranche, Class C Certificate of the Freddie Mac securitization, FREMF Mortgage Trust 2016-KLH1 ("FREMF 2016-KLH1") for $107.6 million, net of a $4.4 million discount to face value of $112.0 million. The underlying portfolio is a pool of 28 floating rate multifamily mortgage loans with a cut-off principal balance of $1.5 billion. The Company is required to consolidate the FREMF 2016-KLH1 Trust's assets and liabilities of $1.5 billion and $1.4 billion, respectively, at June 30, 2018. FREMF 2015-KLSF, FREMF 2015-KF07 and FREMF 2016-KLH1 are collectively referred to herein as the FREMF Trusts.

The FREMF Trusts are structured as pass-through entities that receive principal and interest on the underlying collateral and distribute those payments to the certificate holders. The FREMF Trusts are VIEs and the Company is considered to be the primary beneficiary as a result of its ability to replace the special servicer without cause through its ownership of the Class C Certificates and its current designation as the directing certificate holder. The Company's exposure to the obligations of the VIEs is generally limited to the Company's investment in the FREMF Trusts of $188.0 million. Assets of the FREMF Trusts may only be used to settle obligations of the FREMF Trusts. Creditors of the FREMF Trusts have no recourse to the general credit of the Company. The Company is not contractually required to provide and has not provided any form of financial support to the FREMF Trusts. No gain or loss was recognized upon initial consolidation of the FREMF Trusts, but $0.8 million of related costs were expensed. The FREMF Trusts' assets are included in Commercial real estate debt investments and the FREMF Trusts' liabilities are included in Securitized debt of consolidated VIEs in the accompanying Consolidated Statements of Financial Condition.

Upon consolidation, the Company elected the fair value option for the financial assets and liabilities of the FREMF Trusts in order to avoid an accounting mismatch, and to more faithfully represent the economics of its interest in the entities. The fair value option requires that changes in fair value be reflected in the Company's Consolidated Statements of Comprehensive Income (Loss). The Company applied the practical expedient under ASU 2014-07, whereby the Company determines whether the fair value of the financial assets or financial liabilities is more observable as a basis for measuring the less observable financial instruments. The Company has determined that the fair value of the financial liabilities of the FREMF Trusts are more observable, since the prices for these liabilities are primarily available from third-party pricing services utilized for multifamily mortgage-backed securities, while the individual assets of the trusts are inherently less capable of precise measurement given their illiquid nature and the limitations on available information related to these assets. Given that the Company's methodology for valuing the financial assets of the FREMF Trusts are an aggregate fair value derived from the fair value of the financial liabilities, the Company has determined that the fair value of each of the financial assets in their entirety should be classified in Level 2 of the fair value measurement hierarchy.

The FREMF Trusts mortgage loans had an unpaid principal balance of $2.5 billion at June 30, 2018. At June 30, 2018, there are no loans 90 days or more past due or on nonaccrual status. There is no gain or loss attributable to instrument-specific credit risk of the underlying loans or securitized debt securities at June 30, 2018 based upon the Company's process of monitoring events of default on the underlying mortgage loans.

The Company consolidates a residential mortgage trust that issued residential mortgage-backed securities that are collateralized by residential mortgage loans that had been transferred to the trust by one of the Company's subsidiaries. The Company owns most of the mortgage-backed securities issued by this VIE, including the subordinate securities, and a subsidiary of the Company continues to be the master servicer. As such, the Company is deemed to be the primary beneficiary of the residential mortgage trust and consolidates the entity. The Company has elected the fair value option for the financial assets and liabilities of this VIE, but has elected not to apply the practical expedient under ASU 2014-13 as prices of both the financial assets and financial liabilities of the residential mortgage trust are available from third-party pricing services. The contractual principal amount of the residential mortgage trust's debt held by third parties was $32.9 million at June 30, 2018. The Company also consolidates a residential securitization trust in which it had purchased subordinated securities because its liquidation rights over the trust became exercisable in December 2017. The Company has elected the fair value option for the financial assets and liabilities of this VIE, but has elected not

to apply the practical expedient under ASU 2014-13 as prices of both the financial assets and financial liabilities of the residential mortgage trust are available from third-party pricing services. The contractual principal amount of the residential mortgage trust's debt held by third parties was $85.2 million at June 30, 2018.

In March 2018, the Company closed OBX 2018-01 Trust ("OBX Trust"), with a face value of $327.5 million. The securitization represented a financing transaction which provided non-recourse financing to the Company collateralized by residential mortgage loans purchased by the Company. A total of $279.2 million of bonds were issued to third parties and the Company retained $60.9 million of mortgage-backed securities. The Company is deemed to be the primary beneficiary and consolidates the OBX Trust because it has power to direct the activities that most significantly impact the OBX Trust's performance and holds a variable interest that could be potentially significant to this VIE. The Company has elected the fair value option for the financial assets and liabilities of this VIE, but has elected not to apply the practical expedient under ASU 2014-13 as prices of both the financial assets and financial liabilities of the residential mortgage trust are available from third-party pricing services. The Company incurred approximately $1.5 million of costs in connection with the securitization that were expensed as incurred during the first quarter ended March 31, 2018. The contractual principal amount of the OBX Trust's debt held by third parties was $257.5 million at June 30, 2018.

Although the loans have been sold for bankruptcy and state law purposes, the transfers of the residential mortgage loans to the OBX Trust did not qualify for sale accounting and are reflected as an intercompany secured borrowing that is eliminated upon consolidation.

In June 2016, a consolidated subsidiary of the Company entered into a $300.0 million credit facility with a third party financial institution. The subsidiary was deemed to be a VIE and the Company was determined to be the primary beneficiary due to its role as collateral manager and because it holds a variable interest in the entity that could be potentially significant to the entity. The Company has pledged corporate loans with a carrying amount of $433.5 million at June 30, 2018 as collateral for this credit facility. The transfers did not qualify for sale accounting and are reflected as an intercompany secured borrowing that is eliminated upon consolidation. At June 30, 2018, the subsidiary had an intercompany receivable of $70.7 million, which eliminates upon consolidation and an Other secured financing of $70.7 million to the third party financial institution.

In July 2017, a consolidated subsidiary of the Company entered into a $150.0 million credit facility with a third party financial institution. The subsidiary was deemed to be a VIE and the Company was determined to be the primary beneficiary due to its role as servicer and because it holds a variable interest in the entity that could potentially be significant to the entity. The Company has transferred corporate loans to the subsidiary with a carrying amount of $208.5 million at June 30, 2018, which continue to be reflected in the Company's Consolidated Statements of Financial Condition in Corporate debt. At June 30, 2018, the subsidiary had an Other secured financing of $75.1 million to the third party financial institution.

The Company also owns variable interests in an entity that invests in MSRs and has structured its operations, funding and capitalization into pools of assets and liabilities, each referred to as a "silo." Owners of variable interests in a given silo are entitled to all of the returns and risk of loss on the investments and operations of that silo and have no substantive recourse to the assets of any other silo. While the Company previously held 100% of the voting interests in this entity, in August 2017, the Company sold 100% of such interests, and entered into an agreement with the entity's affiliated portfolio manager giving the Company the power over the silo in which it owns all of the beneficial interests. As a result, the Company is considered to be the primary beneficiary and consolidates this silo.

As of June 30, 2018, the Company had entered into an agreement to purchase approximately $94 million of a subordinated tranche in a CMBS securitization trust. The securitization closed in July 2018, and the Company consolidated the securitization trust on the closing date. The underlying commercial mortgage loans had a cut-off date principal balance of approximately $933 million.

The Company's exposure to the obligations of its VIEs is generally limited to the Company's investment in the VIEs of $1.6 billion at June 30, 2018. Assets of the VIEs may only be used to settle obligations of the VIEs. Creditors of the VIEs have no recourse to the general credit of the Company. The Company is not contractually required to provide and has not provided any form of financial support to the VIEs. No gains or losses were recognized upon consolidation of existing VIEs. Interest income and expense are recognized using the effective interest method.

The statements of financial condition of the Company's VIEs, excluding the credit facility VIEs and OBX Trust, that are reflected in the Company's Consolidated Statements of Financial Condition at June 30, 2018 and December 31, 2017 are as follows:

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	June 30, 2018		
	FREMF Trusts	Residential Mortgage Loan Trusts	MSR Silo
	(dollars in thousands)		
Assets			
Cash and cash equivalents	$—	$—	$32,443
Commercial real estate debt investments	2,542,413	—	—
Residential mortgage loans	—	214,694	37,842
Mortgage servicing rights	—	—	599,014
Accrued interest receivable	10,951	918	—
Other assets	—	87	33,642
Total assets	$2,553,364	$215,699	$702,941
Liabilities			
Securitized debt (non-recourse) at fair value	$2,354,380	$117,864	$—
Other secured financing	—	—	26,369
Accrued interest payable	4,572	330	—
Accounts payable and other liabilities	—	140	1,693
Total liabilities	$2,358,952	$118,334	$28,062

	December 31, 2017		
	FREMF Trusts	Residential Mortgage Loan Trusts	MSR Silo
	(dollars in thousands)		
Assets			
Cash and cash equivalents	$—	$—	$42,293
Commercial real estate debt investments	2,826,357	—	—
Residential mortgage loans	—	478,811	19,667
Mortgage servicing rights	—	—	580,860
Accrued interest receivable	10,339	1,599	—
Other derivatives, at fair value	—	—	1
Other assets	—	1,418	32,354
Total assets	$2,836,696	$481,828	$675,175
Liabilities			
Securitized debt (non-recourse) at fair value	$2,620,952	$350,819	$—
Other secured financing	—	—	10,496
Accrued interest payable	4,554	931	—
Accounts payable and other liabilities	—	112	4,856
Total liabilities	$2,625,506	$351,862	$15,352

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The statements of comprehensive income (loss) of the Company's VIEs, excluding the credit facility VIEs and OBX Trust, that are reflected in the Company's Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2018 and 2017 are as follows:

	Three Months Ended June 30, 2018		
	FREMF Trusts	Residential Mortgage Loan Trusts	MSR Silo
	(dollars in thousands)		
Net interest income:			
Interest income	$25,100	$ 2,184	$813
Interest expense	15,363	1,089	245
Net interest income	9,737	1,095	568
Realized gain (loss) on disposal of investments	—	(140)	(739)
Net gains (losses) on other derivatives	—	—	1
Net unrealized gains (losses) on instruments measured at fair value through earnings	820	(351)	1,850
Other income (loss)	(4,292)	(74)	28,342
Less: General and administration expenses	—	15	455
Net income (loss)	$6,265	$ 515	$29,567

	Three Months Ended June 30, 2017		
	FREMF Trusts	Residential Mortgage Loan Trusts	MSR Silo
	(dollars in thousands)		
Net interest income:			
Interest income	$24,948	$ 1,171	$491
Interest expense	11,679	298	57
Net interest income	13,269	873	434
Realized gain (loss) on disposal of investments	—	(121)	24
Net unrealized gains (losses) on instruments measured at fair value through earnings	4,387	720	(26,848)
Other income (loss)	(6,224)	(94)	33,338
Less: General and administration expenses	1	17	838
Net income (loss)	$11,431	$ 1,361	$6,110

	Six Months Ended June 30, 2018		
	FREMF Trusts	Residential Mortgage Loan Trusts	MSR Silo
	(dollars in thousands)		
Net interest income:			
Interest income	$48,938	$ 4,557	$1,448

Interest expense	29,197	2,848	437
Net interest income	19,741	1,709	1,011
Realized gain (loss) on disposal of investments	—	1,902	(1,310)
Net gains (losses) on trading assets	—	—	70
Net unrealized gains (losses) on instruments measured at fair value through earnings	1,112	(1,167)	16,465
Other income (loss)	(8,769)	(151)	57,058
Less: General and administration expenses	—	29	927
Net income (loss)	$12,084	$ 2,264	$72,367

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	Six Months Ended June 30, 2017		
	FREMF Trusts	Residential Mortgage Loan Trusts	MSR Silo
	(dollars in thousands)		
Net interest income:			
Interest income	$52,667	$ 2,540	$491
Interest expense	26,255	572	122
Net interest income	26,412	1,968	369
Realized gain (loss) on disposal of investments	—	(382)	(485)
Net unrealized gains (losses) on instruments measured at fair value through earnings	5,089	1,702	(47,112)
Other income (loss)	(12,522)	(191)	67,926
Less: General and administration expenses	1	37	1,940
Net income (loss)	$18,978	$ 3,060	$18,758

The geographic concentrations of credit risk exceeding 5% of the total loan unpaid principal balances related to the Company's VIEs, excluding the credit facility VIEs and OBX Trust, at June 30, 2018 are as follows:

Securitized Loans at Fair Value Geographic Concentration of Credit Risk

FREMF Trusts			Residential Mortgage Loan Trusts		
Property Location	Principal Balance	% of Balance	Property Location	Principal Balance	% of Balance
(dollars in thousands)					
Maryland	$437,110	17.3 %	California	$71,095	32.7 %
Texas	361,075	14.4 %	Florida	18,596	8.6 %
Virginia	329,250	13.1 %	Texas	17,616	8.1 %
New York	280,925	11.2 %	Illinois	15,133	7.0 %
North Carolina	231,335	9.2 %	New Jersey	13,156	6.0 %
Pennsylvania	225,810	9.0 %	Other [1]	81,901	37.6 %
Massachusetts	179,440	7.1 %			
Ohio	156,138	6.2 %			
Other [1]	314,514	12.5 %			
Total	$2,515,597	100.0 %		$217,497	100.0 %

[1] No individual state greater than 5%.

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11. FAIR VALUE MEASUREMENTS

The Company follows fair value guidance in accordance with GAAP to account for its financial instruments that are accounted for at fair value. The fair value of a financial instrument is the amount 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.

GAAP requires classification of financial instruments into a three-level hierarchy based on the priority of the inputs to the valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest priority input that is significant to the fair value measurement of the instrument. Financial assets and liabilities recorded at fair value on the Consolidated Statements of Financial Condition or disclosed in the related notes are categorized based on the inputs to the valuation techniques as follows:

Level 1– inputs to the valuation methodology are quoted prices (unadjusted) for identical assets and liabilities in active markets.

Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – inputs to the valuation methodology are unobservable and significant to overall fair value.

The Company designates its securities as trading, available-for-sale or held-to-maturity depending upon the type of security and the Company’s intent and ability to hold such security to maturity. Securities classified as available-for-sale and trading are reported at fair value on a recurring basis.

The following is a description of the valuation methodologies used for instruments carried at fair value. These methodologies are applied to assets and liabilities across the three-level fair value hierarchy, with the observability of inputs determining the appropriate level.

Residential Investment Securities, interest rate swaps, swaptions and other derivatives are valued using quoted prices or internally estimated prices for similar assets using internal models. The Company incorporates common market pricing methods, including a spread measurement to the Treasury curve as well as underlying characteristics of the particular security including coupon, prepayment speeds, periodic and life caps, rate reset period and expected life of

the security in its estimates of fair value. Fair value estimates for residential mortgage loans are generated by a discounted cash flow model and are primarily based on observable market-based inputs including discount rates, prepayment speeds, delinquency levels, and credit losses. Management reviews and indirectly corroborates its estimates of the fair value derived using internal models by comparing its results to independent prices provided by dealers in the securities and/or third party pricing services. Certain liquid asset classes, such as Agency fixed-rate pass-throughs, may be priced using independent sources such as quoted prices for TBA securities.

Futures contracts are valued using quoted prices for identical instruments in active markets and are classified as Level 1.

Residential Investment Securities, residential mortgage loans, interest rate swap and swaption markets and MBS options are considered to be active markets such that participants transact with sufficient frequency and volume to provide transparent pricing information on an ongoing basis. The liquidity of the Residential Investment Securities, interest rate swaps, swaptions, TBA derivatives and MBS options markets and the similarity of the Company's securities to those actively traded enable the Company to observe quoted prices in the market and utilize those prices as a basis for formulating fair value measurements. Consequently, the Company has classified Residential Investment Securities, interest rate swaps, swaptions, TBA derivatives and MBS options as Level 2 inputs in the fair value hierarchy.

The fair value of commercial mortgage-backed securities classified as available-for-sale is determined based upon quoted prices of similar assets in recent market transactions and requires the application of judgment due to differences in the underlying collateral. Consequently, Commercial real estate debt investments carried at fair value are classified as Level 2.

For the fair value of securitized debt of consolidated VIEs, refer to the Note titled "Variable Interest Entities" for additional information.

The Company classifies its investments in MSRs as Level 3 in the fair value measurements hierarchy. Fair value estimates for these investments are obtained from models, which use significant unobservable inputs in their valuations. These valuations primarily utilize discounted cash flow models that incorporate unobservable market data inputs including prepayment rates, delinquency levels, costs to service and discount rates. Model valuations are then compared to valuations obtained from third-party pricing providers. Management reviews the valuations received from third-party pricing providers and uses them as a point of comparison to its internally modeled values. The valuation of MSRs requires significant judgment by management and the third-party pricing providers. Assumptions used for

which there is a lack of observable inputs may significantly impact the resulting fair value and therefore the Company's financial statements.

The following tables present the estimated fair values of financial instruments measured at fair value on a recurring basis. There were no transfers between levels of the fair value hierarchy during the periods presented.

	June 30, 2018			
	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
Assets:				
Agency mortgage-backed securities	$—	$86,593,058	$—	$86,593,058
Credit risk transfer securities	—	563,796	—	563,796
Non-Agency mortgage-backed securities	—	1,006,785	—	1,006,785
Residential mortgage loans	—	1,666,157	—	1,666,157
Mortgage servicing rights	—	—	599,014	599,014
Commercial real estate debt investments	—	2,857,463	—	2,857,463
Interest rate swaps	—	82,458	—	82,458
Other derivatives	4,857	124,823	—	129,680
Total assets	$4,857	$92,894,540	$599,014	$93,498,411
Liabilities:				
Securitized debt of consolidated VIEs	$—	$2,728,692	$—	$2,728,692
Interest rate swaps	—	376,106	—	376,106
Other derivatives	111,610	6,321	—	117,931
Total liabilities	$111,610	$3,111,119	$—	$3,222,729

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
Assets:				
Agency mortgage-backed securities	$—	$90,551,763	$—	$90,551,763
Credit risk transfer securities	—	651,764	—	651,764
Non-Agency mortgage-backed securities	—	1,097,294	—	1,097,294
Residential mortgage loans	—	1,438,322	—	1,438,322
Mortgage servicing rights	—	—	580,860	580,860
Commercial real estate debt investments	—	3,089,108	—	3,089,108
Interest rate swaps	—	30,272	—	30,272
Other derivatives	218,361	65,252	—	283,613
Total assets	$218,361	$96,923,775	$580,860	$97,722,996
Liabilities:				
Securitized debt of consolidated VIEs	$—	$2,971,771	$—	$2,971,771
Interest rate swaps	—	569,129	—	569,129
Other derivatives	12,285	26,440	—	38,725
Total liabilities	$12,285	$3,567,340	$—	$3,579,625

Quantitative Information about Level 3 Fair Value Measurements

The Company considers unobservable inputs to be those for which market data is not available and that are developed using the best information available to us about the assumptions that market participants would use when pricing the asset. Relevant inputs vary depending on the nature of the instrument being measured at fair value. The following paragraph provides a general description of sensitivities of significant unobservable inputs along with interrelationships between and among the significant unobservable inputs and

their impact on the fair value measurements. The effect of a change in a particular assumption in the sensitivity analysis below is considered independently of changes in any other assumptions. In practice, simultaneous changes in assumptions may not always have a linear effect on the inputs discussed below. Interrelationships may also exist between observable and unobservable inputs. Such relationships have not been included in the discussion below. For each of the individual relationships described below, the inverse relationship would also generally apply. For MSRs, in general, increases in the discount, prepayment or delinquency rates or in annual servicing costs in isolation would result in

a lower fair value measurement. A decline in interest rates could lead to higher-than-expected prepayments of mortgages underlying the Company's investments in MSRs, which in turn could result in a decline in the estimated fair value of MSRs. Refer to the Note titled "Mortgage Servicing Rights" for additional information.

The table below presents information about the significant unobservable inputs used for recurring fair value measurements for Level 3 MSRs. The table does not give effect to the Company's risk management practices that might offset risks inherent in these Level 3 investments.

	June 30, 2018		December 31, 2017	
		Range		Range
Valuation Technique	Unobservable Input [1]	(Weighted Average)	Unobservable Input [1]	(Weighted Average)
Discounted cash flow	Discount rate	9.0% -12.0% (9.4%)	Discount rate	10.0% -15.0% (10.4%)
	Prepayment rate	4.5% - 12.2% (7.4%)	Prepayment rate	4.6% - 22.3% (9.4%)
	Delinquency rate	0.0% - 5.0% (2.4%)	Delinquency rate	0.0% - 13.0% (2.2%)
	Cost to service	$82 - $134 ($106)	Cost to service	$84 - $181 ($102)

(1) Represents rates, estimates and assumptions that the Company believes would be used by market participants when valuing these assets.

The following table summarizes the estimated fair values for financial assets and liabilities at June 30, 2018 and December 31, 2017.

		June 30, 2018		December 31, 2017	
	Level in Fair Value Hierarchy	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:		(dollars in thousands)			
Cash and cash equivalents	1	$1,135,329	$1,135,329	$706,589	$706,589
Agency mortgage-backed securities	2	86,593,058	86,593,058	90,551,763	90,551,763
Credit risk transfer securities	2	563,796	563,796	651,764	651,764
Non-Agency mortgage-backed securities	2	1,006,785	1,006,785	1,097,294	1,097,294
Residential mortgage loans	2	1,666,157	1,666,157	1,438,322	1,438,322
Mortgage servicing rights	3	599,014	599,014	580,860	580,860
Commercial real estate debt investments	2	2,857,463	2,857,463	3,089,108	3,089,108
Commercial real estate debt and preferred equity, held for investment	3	1,251,138	1,258,236	1,029,327	1,035,095
Loans held for sale, net	3	42,458	42,495	—	—
Corporate debt	2	1,256,276	1,254,072	1,011,275	1,014,139
Interest rate swaps	2	82,458	82,458	30,272	30,272
Other derivatives	1,2	129,680	129,680	283,613	283,613
Reverse repurchase agreements	1	259,762	259,762	—	—
Financial liabilities:					
Repurchase agreements	1,2	$75,760,655	$75,760,655	$77,696,343	$77,697,828
Other secured financing	1,2	3,760,487	3,759,980	3,837,528	3,837,595
Securitized debt of consolidated VIEs	2	2,728,692	2,728,692	2,971,771	2,971,771
Mortgage payable	3	309,878	302,149	309,686	310,218
Interest rate swaps	2	376,106	376,106	569,129	569,129
Other derivatives	1,2	117,931	117,931	38,725	38,725

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12. SECURED FINANCING

The Company had outstanding $75.8 billion and $77.7 billion of repurchase agreements with weighted average borrowing rates of 1.91% and 1.89%, after giving effect to the Company's interest rate swaps used to hedge cost of funds, and weighted average remaining maturities of 71 days and

58 days at June 30, 2018 and December 31, 2017, respectively.

At June 30, 2018 and December 31, 2017, the repurchase agreements had the following remaining maturities, collateral types and weighted average rates:

	June 30, 2018							
	Agency Mortgage-Backed Securities	CRTs	Non-Agency Mortgage-Backed Securities	Commercial Loans	Commercial Mortgage-Backed Securities	Total Repurchase Agreements	Weighted Average Rate	
	(dollars in thousands)							
1 day	$—	$—	$ —	$ —	$ —	$—	—	
2 to 29 days	30,476,466	263,467	161,587	—	17,996	30,919,516	2.15	%
30 to 59 days	6,314,836	7,950	—	—	6,155	6,328,941	2.11	%
60 to 89 days	14,105,633	64,443	105,187	—	—	14,275,263	2.15	%
90 to 119 days	9,278,603	—	—	—	—	9,278,603	2.08	%
Over 120 days [1]	14,321,748	—	—	488,579	148,005	14,958,332	2.32	%
Total	$74,497,286	$335,860	$ 266,774	$ 488,579	$ 172,156	$75,760,655	2.17	%

	December 31, 2017							
	Agency Mortgage-Backed Securities	CRTs	Non-Agency Mortgage-Backed Securities	Commercial Loans	Commercial Mortgage-Backed Securities	Total Repurchase Agreements	Weighted Average Rate	
	(dollars in thousands)							
1 day	$—	$—	$ —	$ —	$ —	$—	—	
2 to 29 days	33,421,609	263,528	253,290	—	18,125	33,956,552	1.69	%
30 to 59 days	10,811,515	7,229	3,658	—	6,375	10,828,777	1.44	%
60 to 89 days	13,800,743	7,214	47,830	—	—	13,855,787	1.59	%
90 to 119 days	10,128,006	—	—	—	—	10,128,006	1.39	%
Over 120 days [1]	8,542,108	—	—	385,113	—	8,927,221	1.77	%
Total	$76,703,981	$277,971	$ 304,778	$ 385,113	$ 24,500	$77,696,343	1.61	%

[1] Approximately 0% and 1% of the total repurchase agreements had a remaining maturity over 1 year at June 30, 2018 and December 31, 2017, respectively.

Repurchase agreements and reverse repurchase agreements with the same counterparty and the same maturity are presented net in the Consolidated Statements of Financial Condition when the terms of the agreements permit netting. The following table summarizes the gross amounts of reverse repurchase agreements and repurchase agreements, amounts offset in accordance with netting arrangements and net

amounts of repurchase agreements and reverse repurchase agreements as presented in the Consolidated Statements of Financial Condition at June 30, 2018 and December 31, 2017. Refer to the "Derivative Instruments" Note for

information related to the effect of netting arrangements on the Company's derivative instruments.

	June 30, 2018		December 31, 2017	
	Reverse Repurchase Agreements	Repurchase Agreements	Reverse Repurchase Agreements	Repurchase Agreements
	(dollars in thousands)			
Gross Amounts	$2,909,762	$78,410,655	$1,250,000	$78,946,343
Amounts Offset	(2,650,000)	(2,650,000)	(1,250,000)	(1,250,000)
Netted Amounts	$259,762	$75,760,655	$—	$77,696,343

The Company also finances a portion of its financial assets with advances from the Federal Home Loan Bank of Des Moines ("FHLB Des Moines"). Borrowings from FHLB Des Moines are reported in Other secured financing in the Company's Consolidated Statements of Financial Condition.

At June 30, 2018, $3.6 billion of the advances matures between one to three years. At December 31, 2017, $2.1 billion of advances from the FHLB Des Moines matured beyond three years and $1.4 billion matures between one to three years. The weighted average rate of the advances from

the FHLB Des Moines was 2.40% and 1.49% at June 30, 2018 and December 31, 2017, respectively. The Company held $147.9 million of membership and activity-based stock in the FHLB Des Moines at June 30, 2018 and December 31, 2017, which is reported at cost and included in Other assets on the Company's Consolidated Statements of Financial Condition.

Investments pledged as collateral under secured financing arrangements and interest rate swaps, excluding senior securitized commercial mortgage loans of consolidated VIEs, had an estimated fair value and accrued interest of $85.0 billion and $270.6 million, respectively, at June 30, 2018 and $87.0 billion and $267.3 million, respectively, at December 31, 2017.

The fair value of collateral received in connection with reverse repurchase agreements was $261.1 million as of June 30, 2018. The Company did not sell or repledge any of the collateral received as of June 30, 2018.

13. DERIVATIVE INSTRUMENTS

In connection with the Company's investment/market rate risk management strategy, the Company economically hedges a portion of its interest rate risk by entering into derivative financial instrument contracts, which include interest rate swaps, swaptions and futures contracts. The

Company may also enter into TBA derivatives, MBS options and U.S. Treasury or Eurodollar futures contracts and certain forward purchase commitments to economically hedge its exposure to market risks. The purpose of using derivatives is to manage overall portfolio risk with the potential to generate additional income for distribution to stockholders. These derivatives are subject to changes in market values resulting from changes in interest rates, volatility, Agency mortgage-backed security spreads to U.S. Treasuries and market liquidity. The use of derivatives also creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the stated contract. Additionally, the Company may have to pledge cash or assets as collateral for the derivative transactions, the amount of which may vary based on the market value and terms of the derivative contract. In the case of MAC interest rate swaps, the Company may make or receive a payment at the time of entering into such interest rate swap to compensate for the out of market nature of such interest rate swap. Similar to other interest rate swaps, the Company may have to pledge cash or assets as collateral for the MAC interest rate swap transactions. In the event of a default by the counterparty, the Company could have difficulty obtaining its Residential Investment Securities pledged as collateral as well as receiving payments in accordance with the terms of the derivative contracts.

The table below summarizes fair value information about our derivative assets and liabilities at June 30, 2018 and December 31, 2017:

Derivatives Instruments	Balance Sheet Location	June 30, 2018	December 31, 2017
Assets:		(dollars in thousands)	
Interest rate swaps	Interest rate swaps, at fair value	$82,458	$ 30,272
Interest rate swaptions	Other derivatives, at fair value	82,034	36,150
TBA derivatives	Other derivatives, at fair value	36,394	29,067
Futures contracts	Other derivatives, at fair value	4,857	218,361
Purchase commitments	Other derivatives, at fair value	258	35
Credit derivatives [1]	Other derivatives, at fair value	6,137	—
		$212,138	$ 313,885
Liabilities:			

Interest rate swaps	Interest rate swaps, at fair value	$376,106	$ 569,129
TBA derivatives	Other derivatives, at fair value	63	21,776
Futures contracts	Other derivatives, at fair value	111,610	12,285
Purchase commitments	Other derivatives, at fair value	25	157
Credit derivatives [1]	Other derivatives, at fair value	6,233	4,507
		$494,037	$ 607,854

(1) The notional amount of the credit derivatives in which the Company purchased protection was $60.0 million at June 30, 2018. The maximum potential amount of future payments is the notional amount of $357.6 million and $125.0 million at June 30, 2018 and December 31, 2017, respectively. The credit derivative tranches referencing the basket of bonds had a range of ratings between AAA and BBB-.

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The following table summarizes certain characteristics of the Company's interest rate swaps at June 30, 2018 and December 31, 2017:

June 30, 2018

Maturity	Current Notional [1]	Weighted Average Pay Rate	Weighted Average Receive Rate	Weighted Average Years to Maturity
(dollars in thousands)				
0 - 3 years	$32,086,800	1.76 %	2.34 %	1.62
3 - 6 years	15,449,650	2.27 %	2.31 %	4.67
6 - 10 years	12,476,900	2.45 %	2.24 %	8.59
Greater than 10 years	4,076,400	3.58 %	2.21 %	17.48
Total / Weighted Average	$64,089,750	2.08 %	2.31 %	4.43

December 31, 2017

Maturity	Current Notional [1]	Weighted Average Pay Rate [2] [3]	Weighted Average Receive Rate [2]	Weighted Average Years to Maturity [2]
(dollars in thousands)				
0 - 3 years	$6,532,000	1.56 %	1.62 %	2.08
3 - 6 years	14,791,800	2.12 %	1.57 %	4.51
6 - 10 years	10,179,000	2.35 %	1.58 %	8.04
Greater than 10 years	3,826,400	3.65 %	1.51 %	18.47
Total / Weighted Average	$35,329,200	2.22 %	1.58 %	6.72

[1] There were no forward starting swaps at June 30, 2018. Notional amount includes $8.1 billion of forward starting pay fixed swaps at December 31, 2017.
[2] Excludes forward starting swaps.
[3] Weighted average fixed rate on forward starting pay fixed swaps was 1.86% at December 31, 2017.

The following table presents swaptions outstanding at June 30, 2018 and December 31, 2017.

June 30, 2018	Current Underlying Notional	Weighted Average Underlying Pay Rate	Weighted Average Underlying Receive Rate	Weighted Average Underlying Years to Maturity	Weighted Average Months to Expiration
(dollars in thousands)					
Long	$3,250,000	2.75 %	3M LIBOR	10.28	3.16

December 31, 2017	Current Underlying Notional	Weighted Average Underlying Pay Rate	Weighted Average Underlying Receive Rate	Weighted Average Underlying Years to Maturity	Weighted Average Months to Expiration
(dollars in thousands)					
Long	$6,000,000	2.62 %	3M LIBOR	9.97	4.49

The following table summarizes certain characteristics of the Company's TBA derivatives at June 30, 2018 and December 31, 2017:

June 30, 2018				
Purchase and sale contracts for derivative TBAs	Notional	Implied Cost Basis	Implied Market Value	Net Carrying Value
(dollars in thousands)				
Purchase contracts	$8,000,000	$8,144,363	$8,180,694	$36,331

December 31, 2017				
Purchase and sale contracts for derivative TBAs	Notional	Implied Cost Basis	Implied Market Value	Net Carrying Value
(dollars in thousands)				
Purchase contracts	$15,828,000	$16,381,826	$16,390,251	$8,425
Sale contracts	(250,000)	(254,804)	(255,938)	(1,134)
Net TBA derivatives	$15,578,000	$16,127,022	$16,134,313	$7,291

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The following table summarizes certain characteristics of the Company's futures derivatives at June 30, 2018 and December 31, 2017:

	June 30, 2018		
	Notional - Long Positions	Notional - Short Positions	Weighted Average Years to Maturity
	(dollars in thousands)		
U.S. Treasury futures - 2 year	$—	$(480,000)	2.00
U.S. Treasury futures - 5 year	$—	$(4,987,400)	4.42
U.S. Treasury futures - 10 year and greater	—	(10,274,500)	7.13
Total	$—	$(15,741,900)	6.12

	December 31, 2017		
	Notional - Long Positions	Notional - Short Positions	Weighted Average Years to Maturity
	(dollars in thousands)		
2-year swap equivalent Eurodollar contracts	$—	$(17,161,000)	2.00
U.S. Treasury futures - 5 year	—	(4,217,400)	4.41
U.S. Treasury futures - 10 year and greater	—	(4,914,500)	7.01
Total	$—	$(26,292,900)	3.32

The Company presents derivative contracts on a gross basis on the Consolidated Statements of Financial Condition. Derivative contracts may contain legally enforceable provisions that allow for netting or setting off receivables and payables with each counterparty.

The following tables present information about derivative assets and liabilities that are subject to such provisions and can potentially be offset on our Consolidated Statements of Financial Condition at June 30, 2018 and December 31, 2017, respectively.

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	June 30, 2018			
		Amounts Eligible for Offset		
	Gross Amounts	Financial Instruments	Cash Collateral	Net Amounts
Assets:	(dollars in thousands)			
Interest rate swaps, at fair value	$82,458	$(44,260)	$ —	$38,198
Interest rate swaptions, at fair value	82,034	—	—	82,034
TBA derivatives, at fair value	36,394	(63)	—	36,331
Futures contracts, at fair value	4,857	(4,857)	—	—
Purchase commitments	258	—	—	258
Credit derivatives	6,137	(5,736)	—	401
Liabilities:				
Interest rate swaps, at fair value	$376,106	$(44,260)	$ —	$331,846
TBA derivatives, at fair value	63	(63)	—	—
Futures contracts, at fair value	111,610	(4,857)	(106,753)	—
Purchase commitments	25	—	—	25
Credit derivatives	6,233	(5,736)	(497)	—

	December 31, 2017			
		Amounts Eligible for Offset		
	Gross Amounts	Financial Instruments	Cash Collateral	Net Amounts
Assets:	(dollars in thousands)			
Interest rate swaps, at fair value	$30,272	$(27,379)	$ —	$2,893
Interest rate swaptions, at fair value	36,150	—	—	36,150
TBA derivatives, at fair value	29,067	(12,551)	—	16,516
Futures contracts, at fair value	218,361	(12,285)	—	206,076
Purchase commitments	35	—	—	35
Liabilities:				
Interest rate swaps, at fair value	$569,129	$(27,379)	$ —	$541,750
TBA derivatives, at fair value	21,776	(12,551)	—	9,225
Futures contracts, at fair value	12,285	(12,285)	—	—
Purchase commitments	157	—	—	157
Credit derivatives	4,507	—	(3,520)	987

The effect of interest rate swaps on the Consolidated Statements of Comprehensive Income (Loss) is as follows:

Location on Consolidated Statements of Comprehensive Income (Loss)		
Net Interest Component of	Realized Gains (Losses) on Termination	Unrealized Gains (Losses) on

	Interest Rate Swaps	or Maturity of Interest Rate Swaps	Interest Rate Swaps
	(dollars in thousands)		
Three Months Ended:			
June 30, 2018	$31,475	$ —	$343,475
June 30, 2017	$(96,470)	$ (58)	$(177,567)
Six Months Ended:			
June 30, 2018	$(16,685)	$ 834	$1,320,760
June 30, 2017	$(200,626)	$ (58)	$(28,383)

The effect of other derivative contracts on the Company's Consolidated Statements of Comprehensive Income (Loss) is as follows:

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Three Months Ended June 30, 2018

Derivative Instruments	Realized Gains (Losses)	Unrealized Gains (Losses)	Amount of Gains (Losses) Recognized in Net Gains (Losses) on Other Derivatives
(dollars in thousands)			
Net TBA derivatives	$(30,228)	$11,123	$(19,105)
Net interest rate swaptions	(35,667)	3,999	(31,668)
Futures	62,618	15,684	78,302
Purchase commitments	—	59	59
Credit derivatives	2,889	3,712	6,601
Total			$34,189

Three Months Ended June 30, 2017

Derivative Instruments	Realized Gains (Losses)	Unrealized Gains (Losses)	Amount of Gains (Losses) Recognized in Net Gains (Losses) on Other Derivatives
(dollars in thousands)			
Net TBA derivatives	$165,777	$(72,844)	$92,933
Net interest rate swaptions	—	(10,438)	(10,438)
Futures	(59,397)	(37,588)	(96,985)
Purchase commitments	—	8	8
Credit derivatives	136	(77)	59
Total			$(14,423)

Six Months Ended June 30, 2018

Derivative Instruments	Realized Gains (Losses)	Unrealized Gains (Losses)	Amount of Gains (Losses) Recognized in Net Gains (Losses) on Other Derivatives
(dollars in thousands)			
Net TBA derivatives	$(308,127)	$29,039	$(279,088)
Net interest rate swaptions	(57,100)	71,220	14,120

Futures	557,630	(312,828)	244,802
Purchase commitments	—	425	425
Credit derivatives	4,402	2,383	6,785
Total			$ (12,956)

Six Months Ended June 30, 2017

Derivative Instruments	Realized Gains (Losses)	Unrealized Gains (Losses)	Amount of Gain (Losses) Recognized in Net Gains (Losses) on Other Derivatives
(dollars in thousands)			
Net TBA derivatives	$ 105,463	$ 10,237	$ 115,700
Net interest rate swaptions	—	(10,438)	(10,438)
Futures	(58,424)	(61,292)	(119,716)
Purchase commitments	—	272	272
Credit derivatives	136	(77)	59
Total			$ (14,123)

Certain of the Company’s derivative contracts are subject to International Swaps and Derivatives Association Master Agreements or other similar agreements which may contain provisions that grant counterparties certain rights with respect to the applicable agreement upon the occurrence of certain events such as (i) a decline in stockholders’ equity in excess of specified thresholds or dollar amounts over set periods of time, (ii) the Company’s failure to maintain its

REIT status, (iii) the Company’s failure to comply with limits on the amount of leverage, and (iv) the Company’s stock being delisted from the New York Stock Exchange.

Upon the occurrence of any one of items (i) through (iv), or another default under the agreement, the counterparty to the applicable agreement has a right to terminate the agreement in accordance with its provisions. The aggregate fair value

of all derivative instruments with the aforementioned features that are in a net liability position at June 30, 2018 was approximately $330.8 million, which represents the maximum amount the Company would be required to pay upon termination. This amount is fully collateralized.

14. COMMON STOCK AND PREFERRED STOCK

At June 30, 2018, the Company's authorized shares of capital stock, par value of $0.01 per share, consisted of 1,909,750,000 shares classified as common stock, 12,000,000 shares classified as 7.625% Series C Cumulative Redeemable Preferred Stock ("Series C Preferred Stock"), 18,400,000 shares classified as 7.50% Series D Cumulative Redeemable Preferred Stock ("Series D Preferred Stock"), 11,500,000 shares of Series E Cumulative Redeemable Preferred Stock ("Series E Preferred Stock"), 28,800,000 shares classified as 6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock ("Series F Preferred Stock") and 19,550,000 shares classified as 6.50% Series G Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock ("Series G Preferred Stock").

(A)Common Stock

At June 30, 2018 and December 31, 2017, the Company had issued and outstanding 1,164,333,831 and 1,159,585,078 shares of common stock, respectively, with a par value of $0.01 per share.

No options were exercised during the six months ended June 30, 2018 and 2017.

During the six months ended June 30, 2018, the Company raised $1.5 million, by issuing 147,000 shares of common stock, through the Direct Purchase and Dividend Reinvestment Program. During the six months ended June 30, 2017, the Company raised $1.3 million, by issuing 113,000 shares of common stock, through the Direct Purchase and Dividend Reinvestment Program.

In January 2018, the Company entered into separate Distribution Agency Agreements (collectively, the "Sales Agreements") with each of Wells Fargo Securities, LLC, Merrill Lynch, Pierce, Fenner & Smith, Incorporated, Barclays Capital Inc., Citigroup Global Markets Inc., Credit Suisse Securities (USA) LLC, Goldman Sachs & Co. LLC, J.P. Morgan Securities LLC, Keefe, Bruyette & Woods, Inc., RBC Capital Markets, LLC and UBS Securities LLC (the "Sales Agents"). The Company may offer and sell shares of its common stock, having an aggregate offering price of up to $1.5 billion from time to time through any of the Sales Agents. During the six months ended June 30, 2018, the Company issued 4.6 million shares under the at-the-market sales program for proceeds of $48.2 million, net of commissions and fees. In July 2018, the Company issued an additional 2.3 million shares under the at-the-market sales

program for proceeds of $23.7 million, net of commissions and fees.

(B)Preferred Stock

On August 25, 2017, the Company redeemed all 7,412,500 of its issued and outstanding shares of 7.875% Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock") for $187.5 million. The cash redemption amount for each share of Series A Preferred Stock was $25.00 plus accrued and unpaid dividends to, and including, the redemption date of August 25, 2017.

At June 30, 2018 and December 31, 2017, the Company had issued and outstanding 7,000,000 and 12,000,000 shares, respectively, of Series C Preferred Stock, with a par value of $0.01 per share and a liquidation preference of $25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series C Preferred Stock is entitled to a dividend at a rate of 7.625% per year based on the $25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series C Preferred Stock is redeemable at $25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing on May 16, 2017 (subject to the Company's right under limited circumstances to redeem the Series C Preferred Stock earlier in order to preserve its qualification as a REIT or under limited circumstances related to a change of control of the Company). During the six months ended June 30, 2018, the Company redeemed 5,000,000 shares of its Series C Preferred Stock for $125.0 million. Through June 30, 2018, the Company had declared and paid all required quarterly dividends on the Series C Preferred Stock, including $1.0 million, or $0.196 per share, for the 5,000,000 shares that were redeemed.

At June 30, 2018 and December 31, 2017, the Company had issued and outstanding 18,400,000 shares of Series D Preferred Stock, with a par value of $0.01 per share and a liquidation preference of $25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series D Preferred Stock is entitled to a dividend at a rate of 7.5% per year based on the $25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series D Preferred Stock is redeemable at $25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing on September 13, 2017 (subject to the Company's right under limited circumstances to redeem the Series D Preferred Stock earlier in order to preserve its qualification as a REIT or under limited circumstances related to a change of control of the Company). Through June 30, 2018, the Company had declared and paid all required quarterly dividends on the Series D Preferred Stock.

At December 31, 2017, the Company had issued and outstanding 11,500,000 shares of 7.625% Series E Preferred

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
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Stock, with a par value of $0.01 per share and a liquidation preference of $25.00 per share plus accrued and unpaid dividends (whether or not declared). During the six months ended June 30, 2018, the Company redeemed all 11,500,000 of its issued and outstanding shares of Series E Preferred Stock for $287.5 million.

At June 30, 2018 and December 31, 2017, the Company had issued and outstanding 28,800,000 shares of its Series F Preferred Stock, with a par value of $0.01 per share and a liquidation preference of $25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series F Preferred Stock is redeemable at $25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing from and including the original issue date to, but excluding September 30, 2022 (subject to the Company's right under limited circumstances to redeem the Series F Preferred Stock earlier in order to preserve its qualification as a REIT or under limited circumstances related to a change of control of the Company), at a fixed rate equal to 6.95% per annum of the $25.00 liquidation preference, and from and including September 30, 2022, at a floating rate equal to three-month LIBOR plus a spread of 4.993% per annum of the $25.00 per share liquidation preference. Through June 30, 2018, the Company had declared and paid all required quarterly dividends on the Series F Preferred Stock.

During the six months ended June 30, 2018, the Company issued 17,000,000 shares of its 6.50% Series G Preferred

Stock, liquidation preference of $25.00 per share, for gross proceeds of $425.0 million before deducting the underwriting discount and other estimated offering expenses. The Series G Preferred Stock is redeemable at $25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing from and including the original issue date to, but excluding March 31, 2023 (subject to the Company's right under limited circumstances to redeem the Series G Preferred Stock earlier in order to preserve its qualification as a REIT or under limited circumstances related to a change of control of the Company), at a fixed rate equal to 6.50% per annum of the $25.00 liquidation preference, and from and including March 31, 2023, at a floating rate equal to three-month LIBOR plus a spread of 4.172% per annum of the $25.00 per share liquidation preference. Through June 30, 2018, the Company had declared and paid all required quarterly dividends on the Series G Preferred Stock.

The Series C Preferred Stock, Series D Preferred Stock, Series F Preferred Stock and Series G Preferred Stock rank senior to the common stock of the Company.

(C)Distributions to Stockholders

The following table provides a summary of the Company's dividend distribution activity for the periods presented:

	Six Months Ended	
	June 30, 2018	June 30, 2017
	(dollars in thousands, except per share data)	
Distributions declared to common stockholders	$697,197	$611,400
Distributions declared per common share	$0.60	$0.60
Distributions paid to common stockholders after period end	$349,300	$305,709
Distributions paid per common share after period end	$0.30	$—
Date of distributions paid to common stockholders after period end	July 31, 2018	July 31, 2017
Dividends declared to Series A Preferred stockholders	$—	$7,296

Dividends declared per share of Series A Preferred Stock	$—	$0.984
Dividends declared to Series C Preferred stockholders	$7,652	$11,438
Dividends declared per share of Series C Preferred Stock [(1)]	$0.953	$0.953
Dividends declared to Series D Preferred stockholders	$17,250	$17,250
Dividends declared per share of Series D Preferred Stock	$0.938	$0.938
Dividends declared to Series E Preferred stockholders	$2,253	$10,962
Dividends declared per share of Series E Preferred Stock	$0.196	$0.953
Dividends declared to Series F Preferred stockholders	$25,020	$—
Dividends declared per share of Series F Preferred Stock	$0.869	$—
Dividends declared to Series G Preferred stockholders	$12,968	$—
Dividends declared per share of Series G Preferred Stock	$0.763	$—

(1) Includes dividends declared per share for shares outstanding at June 30, 2018.

15. INTEREST INCOME AND INTEREST EXPENSE

The following table presents the components of the Company's interest income and interest expense for the three and six months ended June 30, 2018 and 2017.

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	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Interest income:	(dollars in thousands)			
Residential Investment Securities	$662,750	$459,308	$1,442,338	$975,218
Residential mortgage loans	18,868	7,417	34,373	11,281
Commercial investment portfolio [1]	79,343	68,153	151,800	132,498
Reverse repurchase agreements	15,845	2,548	27,782	6,156
Total interest income	776,806	537,426	1,656,293	1,125,153
Interest expense:				
Repurchase agreements	400,475	197,151	731,849	370,241
Securitized debt of consolidated VIEs	18,201	11,977	33,853	26,827
Participation sold	—	42	—	195
Other	24,016	13,111	44,411	23,443
Total interest expense	442,692	222,281	810,113	420,706
Net interest income	$334,114	$315,145	$846,180	$704,447

[1] Includes commercial real estate debt, preferred equity and corporate debt.

16. GOODWILL

At June 30, 2018 and December 31, 2017, Goodwill totaled $71.8 million.

17. NET INCOME (LOSS) PER COMMON SHARE

The following table presents a reconciliation of net income (loss) and shares used in calculating basic and diluted net income (loss) per share for the three and six months ended June 30, 2018 and 2017.

	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	(dollars in thousands, except per share data)			
Net income (loss)	$595,887	$ 14,522	$1,923,591	$ 454,930
Net income (loss) attributable to noncontrolling interest	(32)	(102)	(128)	(205)
Net income (loss) attributable to Annaly	595,919	14,624	1,923,719	455,135
Dividends on preferred stock	31,377	23,473	65,143	46,946
Net income (loss) available (related) to common stockholders	$564,542	$ (8,849)	$1,858,576	$ 408,189
Weighted average shares of common stock outstanding-basic	1,160,436,771	1,019,000,817	1,160,029,575	1,018,971,942
Add: Effect of stock awards, if dilutive	542,674	—	514,005	385,755
Weighted average shares of common stock outstanding-diluted	1,160,979,445	1,019,000,817	1,160,543,580	1,019,357,697
Net income (loss) per share available (related) to common share:				
Basic	$0.49	$ (0.01)	$1.60	$ 0.40
Diluted	$0.49	$ (0.01)	$1.60	$ 0.40

Options to purchase 0.5 million and 0.8 million shares of common stock were outstanding and considered anti-dilutive as their exercise price and option expense exceeded the average stock price for the three and six months ended June 30, 2018 and 2017, respectively.

18. LONG-TERM STOCK INCENTIVE PLAN

The Company maintains the 2010 Equity Incentive Plan (the “Plan”), which authorizes the Compensation Committee of the Board to grant options, stock appreciation rights, dividend equivalent rights, or other share-based awards, including restricted shares up to an aggregate of 25,000,000 shares, subject to adjustments as provided in the Plan. The Company

had previously adopted a long-term stock incentive plan for executive officers, key employees and non-employee directors (the “Prior Plan”). The Prior Plan authorized the Compensation Committee of the Board to grant awards, including non-qualified options as well as incentive stock options as defined under Section 422 of the Code. The Prior Plan authorized the granting of options or other awards for an aggregate of the greater of 500,000 shares or 9.5% of the diluted outstanding shares of the Company’s common stock, up to a ceiling of 8,932,921 shares. No further awards will be made under the Prior Plan, although existing awards remain outstanding.

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Stock options were issued at the market price on the date of grant, subject to an immediate or four year vesting in four equal installments with a contractual term of 5 or 10 years.

The following table sets forth activity related to the Company's stock options awarded under the Prior Plan:

	Six Months Ended June 30, 2018		June 30, 2017	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Options outstanding at the beginning of year	794,125	$ 15.30	1,125,625	$ 15.43
Granted	—	—	—	—
Exercised	—	—	—	—
Forfeited	—	—	(117,000)	15.85
Expired	(290,200)	16.45	(199,500)	15.74
Options outstanding at the end of period	503,925	$ 14.63	809,125	$ 15.29
Options exercisable at the end of the period	503,925	$ 14.63	809,125	$ 15.29

The weighted average remaining contractual term was approximately 0.5 years and 1.2 years for stock options outstanding and exercisable at June 30, 2018 and 2017, respectively.

At June 30, 2018 and 2017, there was no unrecognized compensation cost related to nonvested share-based compensation awards.

19. INCOME TAXES

For the three months ended June 30, 2018 the Company was qualified to be taxed as a REIT under Code Sections 856 through 860. As a REIT, the Company will not incur federal income tax to the extent that it distributes its taxable income to its stockholders. To maintain qualification as a REIT, the Company must distribute at least 90% of its annual REIT taxable income to its stockholders and meet certain other requirements that relate to, among other things, assets it may hold, income it may generate and its stockholder composition. It is generally the Company's policy to distribute 100% of its REIT taxable income. To the extent there is any undistributed REIT taxable income at the end of a year, the Company distributes such shortfall within the next year as permitted by the Code.

The state and local tax jurisdictions for which the Company is subject to tax-filing obligations recognize the Company's status as a REIT, and therefore, the Company generally does not pay income tax in such jurisdictions. The Company may, however, be subject to certain minimum state and local tax filing fees as well as certain excise, franchise or business taxes. The Company's TRSs are subject to federal, state and local taxes.

During the three and six months ended June 30, 2018, the Company recorded $3.3 million and $3.8 million of income tax expense, respectively, attributable to its TRSs. During the three and six months ended June 30, 2017, the Company

recorded $0.3 million of income tax benefit and $0.6 million of income tax expense, respectively, attributable to its TRSs.

The Company's federal, state and local tax returns from 2014 and forward remain open for examination.

On December 22, 2017, tax legislation was enacted, informally known as the Tax Cuts and Jobs Act (the "TCJA"), that significantly changes the U.S. federal income tax laws applicable to businesses and their owners, including REITs and their stockholders. While technical corrections or other amendments to the TCJA or administrative guidance interpreting the TCJA may be forthcoming at any time, GAAP requires the Company to apply the TCJA provisions, as written, to the Company's consolidated financial statements in terms of recording and measuring deferred tax assets and liabilities that will be recognized in 2018 or further. Due to the timing of the enacted legislation as well as the technical corrections, amendments or administrative guidance that could clarify the treatment of certain provisions, the SEC issued guidance that allows for entities without the necessary information to complete the accounting analysis to determine a reasonable estimate of the effects of the TCJA. These amounts can then be revised once further clarity can be reached over the course of the coming year.

The provisions of the TCJA, as written, which includes the change to the federal corporate income tax rate from 35% to 21%, was applied and did not have a material impact on the Company's consolidated financial statements. To the extent technical corrections or other amendments to the TCJA or administrative guidance interpreting the TCJA are released, the Company will revisit its analysis and conclusions, if relevant.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1. Financial Statements

20. LEASE COMMITMENTS AND CONTINGENCIES

Commitments

In September 2014, the Company entered into a non-cancelable lease for office space which commenced in July 2014 and expires in September 2025. The lease expense for

each of the three months ended June 30, 2018 and 2017 was $0.8 million. The Company's aggregate future minimum lease payments totaled $27.3 million.
The following table details the future lease payments:

Years Ending December 31,	Lease Commitments (dollars in thousands)
2018 (remaining)	$ 1,782
2019	3,565
2020	3,652
2021	3,862
2022	3,862
Later years	10,619
Total	$ 27,342

Contingencies

From time to time, the Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Company's consolidated financial statements. There were no material contingencies at June 30, 2018 and December 31, 2017.

21. RISK MANAGEMENT
The primary risks to the Company are liquidity, investment/market risk and credit risk. Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond the Company's control. Changes in the general level of interest rates can affect net interest income, which is the difference between the interest income earned on interest earning assets and the interest expense incurred in connection with the interest bearing liabilities, by affecting the spread between the interest earning assets and interest bearing liabilities. Changes in the level of interest rates can also affect the value of the interest earning assets and the Company's ability to realize gains from the sale of these assets. A decline in the value of the interest earning assets pledged as collateral for borrowings under repurchase agreements and derivative contracts could result in the counterparties demanding additional collateral or liquidating some of the existing collateral to reduce borrowing levels.
The Company may seek to mitigate the potential financial impact by entering into interest rate agreements such as interest rate swaps, interest rate swaptions and other hedges.

Weakness in the mortgage market, the shape of the yield curve and changes in the expectations for the volatility of future interest rates may adversely affect the performance and market value of the Company's investments. This could

negatively impact the Company's book value. Furthermore, if many of the Company's lenders are unwilling or unable to provide additional financing, the Company could be forced to sell its investments at an inopportune time when prices are depressed. The Company has established policies and procedures for mitigating risks, including conducting scenario and sensitivity analyses and utilizing a range of hedging strategies.

The payment of principal and interest on the Freddie Mac and Fannie Mae Agency mortgage-backed securities, which exclude CRT securities issued by Freddie Mac and Fannie Mae, is guaranteed by those respective agencies and the payment of principal and interest on Ginnie Mae Agency mortgage-backed securities is backed by the full faith and credit of the U.S. government. Substantially all of the Company's Agency mortgage-backed securities have an actual or implied "AAA" rating.

The Company faces credit risk on the portions of its portfolio which is not guaranteed by the respective Agency or by the full faith and credit of the U.S. government. The Company is exposed to credit risk on CRE Debt and Preferred Equity Investments, investments in commercial real estate, commercial mortgage-backed securities, residential mortgage loans, CRT securities, other non-Agency mortgage-backed securities, and corporate debt. MSR values may also be adversely impacted if overall costs to service the underlying mortgage loans increase due to borrower performance. The Company is exposed to risk of loss if an issuer, borrower, tenant or counterparty fails to perform its obligations under contractual terms. The Company has established policies and procedures for mitigating credit risk, including reviewing and establishing limits for credit exposure, limiting transactions with specific counterparties, maintaining qualifying collateral and continually assessing the creditworthiness of issuers, borrowers, tenants and counterparties.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1. Financial Statements

22. ARCOLA REGULATORY REQUIREMENTS

Arcola is subject to regulations of the securities business that include but are not limited to trade practices, use and safekeeping of funds and securities, capital structure, recordkeeping and conduct of directors, officers and employees.

As a self-clearing, registered broker dealer, Arcola is required to maintain minimum net capital by FINRA. At June 30, 2018 Arcola had a minimum net capital requirement of $0.3 million. Arcola consistently operates with capital in excess of its regulatory capital requirements. Arcola's regulatory net capital as defined by SEC Rule 15c3-1, at June 30, 2018 was $389.5 million with excess net capital of $389.2 million.

23. RELATED PARTY TRANSACTIONS

Management Agreement

The Company and the Manager have entered into a management agreement pursuant to which the Company's management is conducted by the Manager through the authority delegated to it in the Management Agreement and pursuant to the policies established by the Board (the "Externalization"). The management agreement was effective as of July 1, 2013 and was amended on November 5, 2014, amended and restated on April 12, 2016, and amended and restated on August 1, 2018 (the management agreement, as amended and restated, is referred to as "Management Agreement").

Under the Management Agreement, the Manager, subject to the supervision and direction of the Company's Board, is responsible for (i) the selection, purchase and sale of assets for the Company's investment portfolio; (ii) recommending alternative forms of capital raising; (iii) supervising the Company's financing and hedging activities; and (iv) day to day management functions. The Manager also performs such other supervisory and management services and activities relating to the Company's assets and operations as may be appropriate. In exchange for the management services, the Company pays the Manager a monthly management fee in an amount equal to 1/12th of 1.05% of our stockholders' equity (as defined in the Management Agreement), and the Manager is responsible for providing personnel to manage the Company, and paying all compensation and benefit expenses associated with such personnel. The Company does not pay the Manager any incentive fees.

For the three and six months ended June 30, 2018, the compensation and management fee was $45.6 million and$90.1 million, respectively. For the three and six months ended June 30, 2017, the compensation and management fee was $38.9 million and $78.2 million, respectively. At June 30, 2018 and December 31, 2017, the Company had amounts payable to the Manager of $14.7 million and $13.8 million, respectively.

The Management Agreement's current term ends on December 31, 2019 and will automatically renew for successive two-year terms unless at least two-thirds of the Company's independent directors or the holders of a majority of the outstanding shares of the Company's common stock in their sole discretion elect to terminate the agreement for any or no reason upon 365 days prior written notice (such notice, a "Termination Notice").

If the Company makes an election to terminate the Management Agreement, the Company may elect to accelerate the Termination Date to a date that is between seven and 90 days after the date of the Company's delivery of a Termination Notice (the "Notice Delivery Date"). If the Company does not make an election to accelerate the Termination Date, then the Manager may elect to accelerate the Termination Date to the date that is 90 days after the Notice Delivery Date. If the Termination Date is accelerated (such date, the "Accelerated Termination Date") by either the Company or the Manager, in addition to any amounts accrued for the period prior to the Accelerated Termination

Date, the Company shall pay the Manager an acceleration fee (the "Acceleration Fee") in an amount equal to the average annual management fee earned by the Manager during the 24-month period immediately preceding such Accelerated Termination Date multiplied by a fraction with a numerator of 365 minus the number of days from the Notice Delivery Date to the Accelerated Termination Date, and a denominator of 365.

The Amended Management Agreement may also be terminated by the Manager for any reason or no reason upon 365 days prior written notice, or with shorter notice periods by either the Company or the Manager for cause or by the Company in the event of a sale of the Manager that was not pre-approved by the Independent Directors.

At any time during the term or any renewal term the Company may deliver to the Manager written notice of the Company's intention to terminate the Management Agreement. The Company must designate a date not less than one year from the date of the notice on which the Management Agreement will terminate. The Management Agreement also provides that the Manager may terminate the Management Agreement by providing to the Company prior written notice of its intention to terminate the Management Agreement no less than one year prior to the date designated by the Manager on which the Manager would cease to provide services or such earlier date as determined by the Company in its sole discretion.

Following the Externalization, the Company continues to retain employees at certain of the Company's subsidiaries for regulatory or corporate efficiency reasons. All compensation expenses associated with such retained employees reduce the amount paid to the Manager.

The Management Agreement may be amended or modified by agreement between the Company and the Manager.

24. SUBSEQUENT EVENTS

On August 1, 2018, the Company completed and closed a securitization of residential mortgage loans, OBX 2018-EXP1 Trust, with a face value of $383.4 million. The securitization represented a financing transaction which provided non-recourse financing to the Company collateralized by residential mortgage loans purchased by the Company.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 2. Management's Discussion And Analysis

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

Special Note Regarding Forward-Looking Statements

Certain statements contained in this quarterly report, and certain statements contained in our future filings with the Securities and Exchange Commission (the "SEC" or the "Commission"), in our press releases or in our other public or stockholder communications contain or incorporate by reference certain forward-looking statements which are based on various assumptions (some of which are beyond our control) and may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "anticipate," "continue," o similar terms or variations on those terms or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, changes in interest rates; changes in the yield curve; changes in prepayment rates; the availability of mortgage-backed securities and other securities for purchase; the availability of financing and, if available, the terms of any financing; changes in the market value of our assets; changes in business conditions and the general economy; our ability to grow our commercial business; our ability to grow our residential mortgage credit business; our ability to grow our middle market lending business; credit risks related to our investments in credit risk transfer securities, residential mortgage-backed securities and related residential mortgage credit assets, commercial real estate assets and corporate debt; risks related to investments in mortgage servicing rights

("MSRs"); our ability to consummate any contemplated investment opportunities; changes in government regulations or policy affecting our business; our ability to maintain our qualification as a real estate investment trust ("REIT") for U.S. federal income tax purposes; our ability to maintain our exemption from registration under the Investment Company Act; and our ability to consummate the proposed MTGE Acquisition (defined below) on a timely basis or at all, and potential business disruption following the MTGE Acquisition (defined below). For a discussion of the risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements, see "Risk Factors" in our most recent Annual Report on Form 10-K and Item 1A "Risk Factors" in this quarterly report on Form 10-Q. We do not undertake, and specifically disclaim any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our most recent annual report on Form 10-K. All references to "Annaly," "we," "us," or "our" mean Annaly Capital Management, Inc. and all entities owned by us, except where it is made clear that the term means only the parent company. Refer to the section titled "Glossary of Terms" located at the end of this Item 2 for definitions of commonly used terms in this quarterly report on Form 10-Q.

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Item 2. Management's Discussion And Analysis

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ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 2. Management's Discussion And Analysis

Overview

We are a leading diversified capital manager that invests in and finances residential and commercial assets. Our principal business objective is to generate net income for distribution to our stockholders and to preserve capital through prudent selection of investments and continuous management of our portfolio. We are a Maryland corporation that has elected to be taxed as a REIT. We are externally managed by Annaly Management Company LLC ("Manager"). Our common

stock is listed on the New York Stock Exchange under the symbol "NLY."

We use our capital coupled with borrowed funds to invest primarily in real estate related investments, earning the spread between the yield on our assets and the cost of our borrowings and hedging activities.

Our investment groups are comprised of the following:

Investment Groups	Description
Annaly Agency Group	Invests in Agency mortgage-backed securities ("MBS") collateralized by residential mortgages which are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae.
Annaly Residential Credit Group	Invests in non-Agency residential mortgage assets within the securitized product and residential mortgage loan markets.
Annaly Commercial Real Estate Group	Originates and invests in commercial mortgage loans, securities, and other commercial real estate debt and equity investments.
Annaly Middle Market Lending Group	Provides financing to private equity-backed middle market businesses across the capital structure.

For a full discussion of our business, refer to the section titled "Business Overview" in our most recent Annual Report on Form 10-K.

Pending Acquisition of MTGE Investment Corp.

As previously disclosed in a Form 8-K filed with the SEC on May 3, 2018 (the "Merger 8-K"), on May 2, 2018, Annaly, Mountain Merger Sub Corporation, a wholly-owned subsidiary of Annaly ("Purchaser"), and MTGE Investment Corp. ("MTGE") entered into an agreement and plan of merger (the "Merger Agreement"), pursuant to which, subject to the terms and conditions contained therein, we agreed to acquire MTGE (the "MTGE Acquisition"), an externally managed hybrid mortgage REIT, for aggregate consideration to MTGE common shareholders of approximately $900.0 million based on the closing price of our common stock on April 30, 2018. Approximately 50% of such consideration will be payable in shares of our common stock, and approximately 50% will be payable in cash. On May 16, 2018, Purchaser commenced an exchange offer (the "Offer") to purchase all of MTGE's issued and outstanding shares of common stock and, upon the closing of the Offer, subject to customary closing conditions as set forth in the Merger Agreement, MTGE will be merged with and into Purchaser (the "Merger"), with Purchaser surviving the Merger. In addition, as part of the MTGE Acquisition, each share of MTGE 8.125% Series A Cumulative Redeemable Preferred Stock, par value $0.01 per share (each, a "MTGE Preferred Share"), that is outstanding as of immediately prior to the completion of the MTGE Acquisition will be converted into one share of a newly-designated series of our preferred stock, par value $0.01 per share, which we expect will be classified and designated as 8.125% Series H Cumulative Redeemable Preferred Stock, and which will have rights, preferences,

privileges and voting powers substantially the same as a MTGE Preferred Share.

The closing of the MTGE Acquisition is subject to a number of conditions, including the receipt of specified regulatory approvals.

Prior to closing the MTGE Acquisition, MTGE will declare a prorated common dividend to its stockholders with a record date on the fourth business day prior to the completion of the Offer, and payable upon the date of the completion of the Offer. In addition, we expect to declare and pay a prorated common dividend to our stockholders, with a record date on the last business day prior to the completion of the Offer. Each of the dividends will be prorated based on the number of days that elapsed since the record date for the most recent quarterly dividend paid to MTGE's and Annaly's stockholders, respectively, and the amount of such prior quarterly dividend, as applicable.

The MTGE Acquisition is expected to be completed during the third quarter of 2018.

For additional details regarding the terms and conditions of the Merger Agreement and related matters, please refer to the Merger Agreement and the Merger 8-K and the other documentation filed as exhibits thereto. Additional information regarding the transactions contemplated by the Merger Agreement, including associated risks, is contained in a registration statement on Form S-4 that we filed with the SEC in connection with the MTGE Acquisition.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 2. Management's Discussion And Analysis

Business Environment

The three months ended June 30, 2018 signaled a sustained robust U.S. economic expansion while near-term recession risks remained relatively low. The Federal Reserve continued to gradually increase the Federal Funds Target Rate, in turn leading interest rates to move modestly higher. Unlike the challenging environment earlier in 2018, however, volatility declined across asset classes as positive economic fundamentals outweighed political uncertainty over issues such as global trade and the U.S. debt outlook. In this environment, we continued to take a defensive approach in our positioning, adjusting leverage and hedges to maintain an agnostic rate view. Agency mortgage-backed securities performed well on the back of strong fundamental factors such as benign prepayment speeds and we remain cautiously optimistic on the outlook for agency mortgage-backed securities in the second half of the year. We increased our allocation to credit, as we see select opportunities in some credit sectors, such as residential whole loans where healthy consumer balance sheets support housing fundamentals. Despite the select opportunities, we believe the broader credit sector continues to be fully valued, so we attempt to avoid investment opportunities where we are uncomfortable with the credit fundamentals or credit protection.

Economic Environment

The pace of economic growth picked up in the three months ended June 30, 2018, coming in above estimated potential growth. Measured by real gross domestic product ("GDP"), activity increased by an annualized 4.1% during the three months ended June 30, 2018, much higher than the 2.2% reading for the three months ended March 31, 2018. The rise was due to a reversion of personal consumption rate to an annualized rate of only 4.0% during the three months ended June 30, 2018 compared to a mere 0.5% for the three months ended March 31, 2018. Non-residential investment remained healthy, with firms investing at a 7.4% rate for three months ended June 30, 2018 after a similarly strong 11.5% annualized gain for the three months ended March 31, 2018. Residential investment remained very weak, only expanding by 1.0% during the three months ended June 30, 2018 after declining an annualized (3.4%) during the three months ended March 31, 2018. The trade balance provided a major boost to GDP growth, adding 1.1% to the growth rate during the three months ended June 30, 2018. Much of the increase in exports appeared to stem from foreign firms front-running anticipated tariffs set to become enforced in the third quarter, therefore to reverse in next quarter GDP growth. Meanwhile, the similarly volatile inventories component subtracted (1.00%) from growth in three months ended June 30, 2018, unlikely to boost growth in the second half of 2018. The government continued to add stimulus to the economy, adding 0.37% to real GDP in three months ended June 30, 2018.

The Federal Reserve System ("Fed") currently conducts monetary policy with a dual mandate: full employment and price stability. The unemployment rate fell slightly in the second quarter of 2018 from 4.1% to 4.0%, remaining below the Fed's estimate of the long-run unemployment rate of 4.5%, according to the Bureau of Labor Statistics and Federal Reserve Board. The economy added 211,000 jobs per month during the three months ended June 30, 2018, down slightly from 218,000 jobs added per month in the first quarter of 2018. Labor force growth has increased recently, rising 1.2% on a year-over-year basis compared to 1.0% in March 2018, with the participation rate now unchanged from October 2013 in spite of an aging population. Wage growth, as measured by the year-over-year change in private sector Average Hourly Earnings, has rebounded to 2.74% as of June 2018 compared to 2.64% in March. The Fed sees labor markets continuing to improve in 2018, projecting the unemployment rate to drop to 3.5% as of their June 13, 2018 economic projections.

Inflation remained near the Fed's 2% target during the three months ended June 30, 2018, as measured by the year-over-year changes in the Personal Consumer Expenditure Chain Price Index ("PCE"). The headline PCE measure increased by 2.2% year-over-year in June 2018, up slightly from 2.1% in March 2018. The more stable core PCE measure, which excludes volatile food and energy prices, fell slightly to 1.9% in June 2018 compared to 2.0% in

March 2018, after the latter saw an upward revision from 1.8% previously. The Fed expects the core and headline PCE measures to increase by 2.0% and 2.1% year-over-year by the fourth quarter of 2018, before both rising to 2.1% in the fourth quarter of 2019 where it is expected to remain in 2020 before settling at 2.0% over the longer-run.

The Federal Open Market Committee ("FOMC") continued to support its dual mandate by keeping its target for the federal funds rate at accommodative levels, while gradually reducing the size of its portfolio of U.S. Treasury and Agency mortgage-backed securities holdings. In assessing realized and expected progress towards its objectives, the FOMC kept the target range for the federal funds rate unchanged at 1.50%-1.75% at its May 1-2, 2018 meeting before raising it to 1.75%-2.00% at its June 12-13, 2018 meeting. Continued labor market and inflation improvement led the FOMC to keep its economic outlook optimistic, with the median member revising up their outlook for remaining interest rate hikes in 2018 from one to two as their GDP, unemployment and inflation forecasts all improved. Additionally, the FOMC removed language that the funds rate will only be adjusted gradually and below the long-run level, adding to their flexibility as the hiking cycle continues. In April 2018, the cap of portfolio runoff amount increased from $12.0 billion to $18.0 billion per month for U.S. Treasury securities and from $8.0 billion to $12.0 billion per month for Agency mortgage-backed securities. The program will be increased by the same amount every three months until maximum

monthly runoff levels of $30.0 billion and $20.0 billion, respectively, are reached.

During the three months ended June 30, 2018, the 10-year U.S. Treasury Rate moderated following the sell-off that began in the fourth quarter of 2017 as risks of a trade war and slowing global growth weighed on sentiment. Estimates of term premium, or the compensation required for purchasing

longer-dated Treasury maturities, remained at very low levels, suggesting consistent demand for duration. The mortgage basis, or the spread between the 30-year Agency mortgage-backed security coupon and 10-year U.S. Treasury Rate, was unchanged over the quarter, according to Bloomberg, though fluctuated somewhat.

The following table presents interest rates at each date presented:

	June 30, 2018	December 31, 2017	June 30, 2017
30-Year mortgage current coupon	3.60%	3.00%	3.03%
Mortgage basis	74 bps	59 bps	73 bps
10-Year U.S. Treasury rate	2.86%	2.41%	2.30%
LIBOR:			
1-Month	2.09%	1.56%	1.22%
6-Month	2.50%	1.84%	1.45%

Results of Operations

The results of our operations are affected by various factors, many of which are beyond our control. Certain of such risks and uncertainties are described herein (see "Special Note Regarding Forward-Looking Statements" above) and in Part I, Item 1A. "Risk Factors" of our most recent annual report on Form 10-K.

This Management Discussion and Analysis section contains analysis and discussion of financial results computed in accordance with U.S. generally accepted accounting principles ("GAAP") and non-GAAP measurements. To supplement our consolidated financial statements, which are

prepared and presented in accordance with GAAP, we provide non-GAAP financial measures to enhance investor understanding of our period-over-period operating performance and business trends, as well as for assessing our performance versus that of industry peers.

Please refer to the "Non-GAAP Financial Measures" section for additional information.

Net Income (Loss) Summary

The following table presents financial information related to our results of operations as of and for the three and six months ended June 30, 2018 and 2017.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 2. Management's Discussion And Analysis

	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	(dollars in thousands, except per share data)			
Interest income	$776,806	$537,426	$1,656,293	$1,125,153
Interest expense	442,692	222,281	810,113	420,706
Net interest income	334,114	315,145	846,180	704,447
Realized and unrealized gains (losses)	294,646	(277,794)	1,139,335	(203,529)
Other income (loss)	34,170	30,865	68,193	62,511
Less: General and administrative expenses	63,781	54,023	126,291	107,851
Income (loss) before income taxes	599,149	14,193	1,927,417	455,578
Income taxes	3,262	(329)	3,826	648
Net income (loss)	595,887	14,522	1,923,591	454,930
Net income (loss) attributable to noncontrolling interest	(32)	(102)	(128)	(205)
Net income (loss) attributable to Annaly	595,919	14,624	1,923,719	455,135
Dividends on preferred stock	31,377	23,473	65,143	46,946
Net income (loss) available (related) to common stockholders	$564,542	$(8,849)	$1,858,576	$408,189
Net income (loss) per share available (related) to common stockholders:				
Basic	$0.49	$(0.01)	$1.60	$0.40
Diluted	$0.49	$(0.01)	$1.60	$0.40
Weighted average number of common shares outstanding:				
Basic	1,160,436,777	1,019,000,817	1,160,029,575	1,018,971,942
Diluted	1,160,979,451	1,019,000,817	1,160,543,580	1,019,357,697
Other information:				
Asset portfolio at period-end	$96,314,032	$83,338,423	$96,314,032	$83,338,423
Average total assets	$99,607,615	$84,817,768	$100,325,093	$85,846,860
Average equity	$13,858,396	$12,628,387	$14,196,121	$12,610,915
Leverage at period-end [1]	6.0:1	5.6:1	6.0:1	5.6:1
Economic leverage at period-end [2]	6.4:1	6.4:1	6.4:1	6.4:1
Capital ratio [3]	13.2%	13.2%	13.2%	13.2%
Annualized return on average total assets	2.39%	0.07%	3.83%	1.06%
Annualized return (loss) on average equity	17.20%	0.46%	27.10%	7.21%
Annualized core return on average equity (excluding PAA) [4]	11.05%	10.54%	10.83%	10.61%
Net interest margin [5]	1.53%	1.23%	1.74%	1.35%
Net interest margin (excluding PAA) [4]	1.56%	1.53%	1.54%	1.54%
Average yield on interest earning assets	3.04%	2.58%	3.24%	2.66%
Average yield on interest earning assets (excluding PAA) [4]	3.07%	2.93%	3.03%	2.88%
Average cost of interest bearing liabilities [6]	1.89%	1.74%	1.90%	1.66%
Net interest spread	1.15%	0.84%	1.34%	1.00%
Net interest spread (excluding PAA) [4]	1.18%	1.19%	1.13%	1.22%
Constant prepayment rate	10.1%	10.9%	9.5%	11.2%
Long-term constant prepayment rate	9.1%	10.6%	9.1%	10.6%

Common stock book value per share	$10.35	$11.19	$10.35	$11.19
Interest income (excluding PAA) [4]	$784,322	$610,126	$1,545,414	$1,215,723
Economic interest expense [4] [6]	$411,217	$306,533	$826,798	$593,924
Economic net interest income (excluding PAA) [4]	$373,105	$303,593	$718,616	$621,799
Core earnings [4]	$375,297	$259,901	$878,964	$577,929
Premium amortization adjustment cost (benefit)	$7,516	$72,700	$(110,879)	$90,570
Core earnings (excluding PAA) [4]	$382,813	$332,601	$768,085	$668,499
Core earnings per common share [4]	$0.30	$0.23	$0.70	$0.52
PAA cost (benefit) per common share [4]	$—	$0.07	$(0.09)	$0.09
Core earnings (excluding PAA) per common share [4]	$0.30	$0.30	$0.61	$0.61

(1) Debt consists of repurchase agreements, other secured financing, securitized debt and mortgages payable. Securitized debt and mortgages payable are non-recourse to us.

(2) Computed as the sum of Recourse Debt, TBA derivative notional outstanding and net forward purchases of investments divided by total equity.

(3) Represents the ratio of stockholders' equity to total assets (inclusive of total market value of TBA derivatives and exclusive of securitized debt of consolidated VIEs).

(4) Represents a non-GAAP financial measure. Refer to the "Non-GAAP Financial Measures" section for additional information.

(5) Represents the sum of our interest income plus TBA dollar roll income less interest expense and the net interest component of interest rate swaps divided by the sum of average Interest Earning Assets plus average outstanding TBA contract balances.

(6) Includes GAAP interest expense and the net interest component of interest rate swaps. Prior to the three months ended March 31, 2018, this metric included the net interest component of interest rate swaps used to hedge cost of funds. Beginning with the three months ended March 31, 2018, as a result of changes to our hedging portfolio, this metric reflects the net interest component of all interest rate swaps.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 2. Management's Discussion And Analysis

GAAP
Net income (loss) was $595.9 million, which includes ($32.0) thousand attributable to a noncontrolling interest, or $0.49 per average basic common share, for the three months ended June 30, 2018 compared to $14.5 million, which includes ($0.1) million attributable to a noncontrolling interest, or $(0.01) per average basic common share, for the same period in 2017. We attribute the majority of the change in net income (loss) to the change in unrealized gains (losses) on interest rate swaps, which was $343.5 million for the three months ended June 30, 2018 compared to $(177.6) million for the same period in 2017, reflecting a rise in forward interest rates during the three months ended June 30, 2018 compared to a decline in forward interest rates during the same period in 2017.

Net income (loss) was $1.9 billion, which includes $(0.1) million attributable to a noncontrolling interest, or $1.60 per average basic common share, for the six months ended June 30, 2018 compared to $454.9 million, which includes $(0.2) million attributable to a noncontrolling interest, or $0.40 per average basic common share, for the same period in 2017. We attribute the majority of the change in net income (loss) to the change in unrealized gains (losses) on interest rate swaps, the lower net interest component of interest rate swaps and higher net interest income, partially offset by the change in net unrealized gains (losses) on instruments measured at fair value through earnings. Unrealized gains (losses) on interest rate swaps was $1.3 billion for the six months ended June 30, 2018 compared to $(28.4) million for the same period in 2017, reflecting a rise in forward interest rates during the six months ended June 30, 2018 compared to a decline in forward interest rates during the same period in 2017. The net interest component of interest rate swaps decreased $183.9 million to $(16.7) million for the six months ended June 30, 2018 compared to $(200.6) million for the same period in 2017, reflecting the change to an average net receive rate during the six months ended June 30, 2018 compared to average net pay rates during the same period in 2017. Net interest income increased $141.7 million to $846.2 million for the six months ended June 30, 2018 compared to $704.4 million for the same period in 2017, primarily due to higher coupon income earned resulting from an increase in average Interest Earning Assets, partially offset by an increase in interest expense from higher borrowing rates and an increase in average Interest Bearing Liabilities. Net unrealized gains (losses) on instruments measured at fair value through earnings were $(100.0) million for the six months ended June 30, 2018 compared to $39.9 million for the same period in 2017, primarily due to unfavorable changes in unrealized gains (losses) on Agency interest-only investments, non-Agency mortgage-backed securities and credit risk transfer securities, partially offset by favorable changes in unrealized gains (losses) on MSRs.

Non-GAAP
Core earnings (excluding premium amortization adjustment ("PAA")) were $382.8 million, or $0.30 per average common

share, for the three months ended June 30, 2018 compared to $332.6 million, or $0.30 per average common share, for the same period in 2017. Core earnings (excluding PAA) were $768.1 million, or $0.61 per average common share, for the six months ended June 30, 2018 compared to $668.5 million, or $0.61 per average common share, for the same period in 2017. Core earnings (excluding PAA) increased during each period in 2018 compared to the same periods in 2017 primarily due to higher coupon income earned resulting from an increase in average Interest Earning Assets and favorable changes in the net interest component of interest rate swaps, partially offset by an increase in interest expense from higher borrowing rates, an increase in average Interest Bearing Liabilities and higher amortization on MSRs.

Non-GAAP Financial Measures

To supplement our consolidated financial statements, which are prepared and presented in accordance with GAAP, we provide the following non-GAAP financial measures.

- core earnings and core earnings (excluding PAA);
- core earnings and core earnings (excluding PAA) per average common share;
- annualized core return on average equity (excluding PAA);
- interest income (excluding PAA);
- economic interest expense;
- economic net interest income (excluding PAA);
- average yield on Interest Earning Assets (excluding PAA);
- net interest margin (excluding PAA); and
- net interest spread (excluding PAA).

These measures should not be considered a substitute for, or superior to, financial measures computed in accordance with GAAP. While intended to offer a fuller understanding of our results and operations, non-GAAP financial measures also have limitations. For example, we may calculate our non-GAAP metrics, such as core earnings, or the PAA, differently than our peers making comparative analysis difficult. Additionally, in the case of non-GAAP measures that exclude the PAA, the amount of amortization expense excluding the PAA is not necessarily representative of the amount of future periodic amortization nor is it indicative of the term over which we will amortize the remaining unamortized premium. Changes to actual and estimated prepayments will impact the timing and amount of premium amortization and, as such, both GAAP and non-GAAP results.

These non-GAAP measures provide additional detail to enhance investor understanding of our period-over-period operating performance and business trends, as well as for assessing our performance versus that of industry peers. Additional information pertaining to our use of these non-GAAP financial measures, including discussion of how each such measure is useful to investors, and reconciliations to their most directly comparable GAAP results are provided below.

Core earnings and core earnings (excluding PAA), core earnings and core earnings (excluding PAA) per average common share and annualized core return on average equity (excluding PAA)

Our principal business objective is to generate net income for distribution to our stockholders and to preserve capital through prudent selection of investments, and continuous management of our portfolio. We generate net income by earning a net interest spread on our investment portfolio, which is a function of our interest income from our investment portfolio less financing, hedging and operating costs. Core earnings, which is comprised of interest income plus TBA dollar roll income, less financing and hedging costs and general and administrative expenses, and core earnings (excluding PAA), are used by management and, we believe, used by our analysts and investors to measure our progress in achieving this objective.

We seek to fulfill our principal business objective through a variety of factors including portfolio construction, the degree of market risk exposure and related hedge profile, and the use and forms of leverage, all while operating within the parameters of our capital allocation policy and risk governance framework.

We define "core earnings", a non-GAAP measure, as net income (loss) excluding gains or losses on disposals of investments and termination or maturity of interest rate swaps, unrealized gains or losses on interest rate swaps and instruments measured at fair value through earnings, net gains and losses on other derivatives, impairment losses, net

income (loss) attributable to noncontrolling interest, transaction expenses and certain other non-recurring gains or losses, and inclusive of TBA dollar roll income (a component of Net gains (losses) on other derivatives) and realized amortization of MSRs (a component of net unrealized gains (losses) on instruments measured at fair value through earnings). Core earnings (excluding PAA) excludes the premium amortization adjustment representing the cumulative impact on prior periods, but not the current period, of quarter-over-quarter changes in estimated long-term prepayment speeds related to our Agency mortgage-backed securities.

We believe these non-GAAP measures provide management and investors with additional details regarding our underlying operating results and investment portfolio trends by (i) making adjustments to account for the disparate reporting of changes in fair value where certain instruments are reflected in GAAP net income (loss) while others are reflected in other comprehensive income (loss), and (ii) by excluding certain unrealized, non-cash or episodic components of GAAP net income (loss) in order to provide additional transparency into the operating performance of our portfolio. Annualized core return on average equity (excluding PAA), which is calculated by dividing core earnings (excluding PAA) over average stockholders' equity, provides investors with additional detail on the core earnings generated by our invested equity capital.

The following table presents a reconciliation of GAAP financial results to non-GAAP core earnings for the periods presented:

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Item 2. Management's Discussion And Analysis

	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	(dollars in thousands, except per share data)			
GAAP net income (loss)	$595,887	$14,522	$1,923,591	$454,930
Less:				
Realized (gains) losses on termination or maturity of interest rate swaps	—	58	(834)	58
Unrealized (gains) losses on interest rate swaps	(343,475)	177,567	(1,320,760)	28,383
Net (gains) losses on disposal of investments	66,117	5,516	52,649	281
Net (gains) losses on other derivatives	(34,189)	14,423	12,956	14,104
Net unrealized (gains) losses on instruments measured at fair value through earnings	48,376	(16,240)	99,969	(39,923)
Transaction expenses [1]	—	—	1,519	—
Net (income) loss attributable to noncontrolling interest	32	102	128	205
Plus:				
TBA dollar roll income (loss) [2]	62,491	81,051	150,844	151,019
MSR amortization [3]	(19,942)	(17,098)	(41,098)	(31,128)
Core earnings [4]	375,297	259,901	$878,964	$577,929
Less:				
Premium amortization adjustment cost (benefit)	7,516	72,700	(110,879)	90,570
Core earnings (excluding PAA) [4]	$382,813	$332,601	$768,085	$668,499
GAAP net income (loss) per common share	$0.49	$(0.01)	$1.60	$0.40
Core earnings per common share [4]	$0.30	$0.23	$0.70	$0.52
Core earnings (excluding PAA) per common share [4]	$0.30	$0.30	$0.61	$0.61
Annualized GAAP return (loss) on average equity	17.20%	0.46%	27.10%	7.21%
Annualized core return on average equity (excluding PAA) [4]	11.05%	10.54%	10.83%	10.61%

(1) Represents costs incurred in connection with a securitization of residential whole loans.

(2) Represents a component of Net gains (losses) on other derivatives in the Consolidated Statements of Comprehensive Income (Loss).

(3) Represents the portion of changes in fair value that is attributable to the realization of estimated cash flows on our MSR portfolio and is reported as a component of Net unrealized (gains) losses on instruments measured at fair value through earnings in the Consolidated Statements of Comprehensive Income (Loss).

(4) Represents a non-GAAP financial measure. Refer to the "Non-GAAP Financial Measures" section for additional information.

From time to time, we enter into TBA forward contracts as an alternate means of investing in and financing Agency mortgage-backed securities. A TBA contract is an agreement to purchase or sell, for future delivery, an Agency mortgage-backed security with a specified issuer, term and coupon. A TBA dollar roll represents a transaction where TBA contracts with the same terms but different settlement dates are simultaneously bought and sold. The TBA contract settling in the later month typically prices at a discount to the earlier month contract with the difference in price commonly referred to as the "drop". The drop is a reflection of the expected net interest income from an investment in similar Agency mortgage-backed securities, net of an implied financing cost, that would be foregone as a result of settling the contract in the later month rather than in the earlier month. The drop between the current settlement month price and the forward settlement month price occurs because in the TBA dollar roll market, the party providing the financing is the party that would retain all principal and interest payments accrued during the financing period. Accordingly, TBA dollar roll income generally represents the economic equivalent of the net interest income

earned on the underlying Agency mortgage-backed security less an implied financing cost.

TBA dollar roll transactions are accounted for under GAAP as a series of derivatives transactions. The fair value of TBA

derivatives is based on methods similar to those used to value Agency mortgage-backed securities. We record TBA derivatives at fair value on our Consolidated Statements of Financial Condition and recognize periodic changes in fair value as Net gains (losses) on other derivatives in our Consolidated Statements of Comprehensive Income (Loss), which includes both unrealized and realized gains and losses on derivatives (excluding interest rate swaps).

TBA dollar roll income is calculated as the difference in price between two TBA contracts with the same terms but different settlement dates multiplied by the notional amount of the TBA contract. Although accounted for as derivatives, TBA dollar rolls capture the economic equivalent of net interest income, or carry, on the underlying Agency mortgage-backed security (interest income less an implied cost of financing). TBA dollar roll income is reported as a component of Net gains (losses) on other derivatives in the Consolidated Statements of Comprehensive Income (Loss).

Premium Amortization Adjustment

In accordance with GAAP, we amortize or accrete premiums or discounts into interest income for our Agency mortgage-backed securities, excluding interest-only securities, multifamily and reverse mortgages, taking into account

estimates of future principal prepayments in the calculation of the effective yield. We recalculate the effective yield as differences between anticipated and actual prepayments occur. Using third-party model and market information to project future cash flows and expected remaining lives of securities, the effective interest rate determined for each security is applied as if it had been in place from the date of the security's acquisition. The amortized cost of the security is then adjusted to the amount that would have existed had the new effective yield been applied since the acquisition date. The adjustment to amortized cost is offset with a charge or credit to interest income. Changes in interest rates and other market factors will impact prepayment speed projections and the amount of premium amortization recognized in any given period.

Our GAAP metrics include the unadjusted impact of amortization and accretion associated with this method. Certain of our non-GAAP metrics exclude the effect of the PAA, which quantifies the component of premium amortization representing the cumulative impact on prior periods, but not the current period, of quarter-over-quarter changes in estimated long-term CPR.

The following table illustrates the impact of the PAA on premium amortization expense for our Residential Investment Securities portfolio for the periods presented:

	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	(dollars in thousands)			
Premium amortization expense	$202,426	$251,084	$298,258	$454,718
Less: PAA cost (benefit)	7,516	72,700	(110,879)	90,570
Premium amortization expense (excluding PAA)	$194,910	$178,384	$409,137	$364,148

	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	(per average common share)			
Premium amortization expense	$0.17	$ 0.25	$0.26	$ 0.45
Less: PAA cost (benefit)	—	0.07	(0.09)	0.09
Premium amortization expense (excluding PAA)	$0.17	$ 0.18	$0.35	$ 0.36

Experienced and Projected Long-term CPR

Prepayment speeds, as reflected by the Constant Prepayment Rate ("CPR") and interest rates vary according to the type of investment, conditions in financial markets, competition and other factors, none of which can be predicted with any certainty. In general, as prepayment speeds and expectations

of prepayment speeds on our Agency mortgage-backed securities portfolio increase, related purchase premium amortization increases, thereby reducing the yield on such assets. The following table presents the weighted average experienced CPR and weighted average projected long-term CPR on our Agency mortgage-backed securities portfolio as of or for the periods presented.

Three Months Ended	Experienced CPR [1]	Projected Long-term CPR [2]

June 30, 2018	10.1%	9.1%
June 30, 2017	10.9%	10.6%
Six Months Ended	Experienced CPR [1]	Long-term CPR [2]
June 30, 2018	9.5%	9.1%
June 30, 2017	11.2%	10.6%

[1] For the three and six months ended June 30, 2018 and 2017, respectively.
[2] At June 30, 2018 and 2017, respectively.

Interest income (excluding PAA), economic interest expense and economic net interest income (excluding PAA)

Interest income (excluding PAA) represents interest income excluding the effect of the premium amortization adjustment, and serves as the basis for deriving average yield on Interest Earning Assets (excluding PAA), net interest spread (excluding PAA) and net interest margin (excluding PAA),

which are discussed below. We believe this measure provides management and investors with additional detail to enhance their understanding of our operating results and trends by excluding the component of premium amortization expense representing the cumulative effect of quarter-over-quarter changes in estimated long-term prepayment speeds related to our Agency mortgage-backed securities (other than

interest-only securities), which can obscure underlying trends in the performance of the portfolio.

Economic interest expense is comprised of interest expense, as computed in accordance with GAAP, plus the net interest component of interest rate swaps. Prior to the three months ended March 31, 2018, economic interest expense included the net interest component of interest rate swaps used to hedge cost of funds. Beginning with the three months ended March 31, 2018, as a result of changes to our hedging portfolio, this metric reflects the net interest component of all interest rate swaps. We use interest rate swaps to manage our exposure to changing interest rates on repurchase agreements by economically hedging cash flows associated with these borrowings. Accordingly, adding the net interest component

of interest rate swaps to interest expense, as computed in accordance with GAAP, reflects the total contractual interest expense and thus, provides investors with additional information about the cost of our financing strategy.

Similarly, economic net interest income (excluding PAA), as computed below, provides investors with additional information to enhance their understanding of the net economics of our primary business operations.

The following tables provide GAAP measures of interest expense and net interest income and details with respect to reconciling the aforementioned line items on a non-GAAP basis for each respective period:

Interest Income (excluding PAA)

	GAAP Interest Income	PAA Cost (Benefit)	Interest Income (excluding PAA)
Three Months Ended:	(dollars in thousands)		
June 30, 2018	$776,806	$7,516	$784,322
June 30, 2017	$537,426	$72,700	$610,126
Six Months Ended:			
June 30, 2018	$1,656,293	$(110,879)	$1,545,414
June 30, 2017	$1,125,153	$90,570	$1,215,723

Economic Interest Expense and Economic Net Interest Income (excluding PAA)

	GAAP Interest Expense	Add: Net Interest Component of Interest Rate Swaps (1)	Economic Interest Expense	GAAP Net Interest Income	Less: Net Interest Component of Interest Rate Swaps (1)	Economic Net Interest Income	Add: PAA Cost (Benefit)	Economic Net Interest Income (excluding PAA)
Three Months Ended:	(dollars in thousands)							
June 30, 2018	$442,692	$(31,475)	$411,217	$334,114	$(31,475)	$365,589	$7,516	$373,105
June 30, 2017	$222,281	$84,252	$306,533	$315,145	$84,252	$230,893	$72,700	$303,593
Six Months Ended:								
June 30, 2018	$810,113	$16,685	$826,798	$846,180	$16,685	$829,495	$(110,879)	$718,616
June 30, 2017	$420,706	$173,218	$593,924	$704,447	$173,218	$531,229	$90,570	$621,799

(1) Prior to the three months ended March 31, 2018, economic interest expense included the net interest component of interest rate swaps used to hedge cost of funds. Beginning with the three months ended March 31, 2018, as a result of changes to our hedging portfolio, this metric reflects the net interest component of all interest rate swaps.

Average Yield on Interest Earning Assets (excluding PAA), Net Interest Spread (excluding PAA) and Net Interest Margin (excluding PAA)

Net interest spread (excluding PAA), which is the difference between the average yield on interest earning assets (excluding PAA) and the average cost of interest bearing liabilities, and net interest margin (excluding PAA), which is calculated as sum of interest income (excluding PAA) plus TBA dollar roll income less interest expense and the net

interest component of interest rate swaps divided by the sum of average Interest Earning Assets plus average TBA contract balances, provide management with additional measures of our profitability that management relies upon in monitoring the performance of the business.

Disclosure of these measures, which are presented below, provides investors with additional detail regarding how management evaluates our performance.

Net Interest Spread (excluding PAA)

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	Average Interest Earning Assets [1]	Interest Income (excluding PAA) [2]	Average Yield on Interest Earning Assets (excluding PAA) [2]	Average Interest Bearing Liabilities	Economic Interest Expense [2][3]	Average Cost of Interest Bearing Liabilities [3]	Economic Net Interest Income (excluding PAA) [2]	Net Interest Spread (excluding PAA) [2]
Three Months Ended:	(dollars in thousands)							
June 30, 2018	$102,193,435	$784,322	3.07 %	$87,103,807	$411,217	1.89 %	$373,105	1.18 %
June 30, 2017	$83,427,268	$610,126	2.93 %	$70,486,779	$306,533	1.74 %	$303,593	1.19 %
Six Months Ended:								
June 30, 2018	$102,086,239	$1,545,414	3.03 %	$87,240,130	$826,798	1.90 %	$718,616	1.13 %
June 30, 2017	$84,545,709	$1,215,723	2.88 %	$71,454,874	$593,924	1.66 %	$621,799	1.22 %

(1) Does not reflect the unrealized gains/(losses).

(2) Represents a non-GAAP financial measure. Refer to the "Non-GAAP Financial Measures" section for additional information.

(3) Includes GAAP interest expense and the net interest component of interest rate swaps. Prior to the three months ended March 31, 2018, this metric included the net interest component of interest rate swaps used to hedge cost of funds. Beginning with the three months ended March 31, 2018, as a result of changes to our hedging portfolio, this metric reflects the net interest component of all interest rate swaps.

Net Interest Margin (excluding PAA)

	Interest Income (excluding PAA) [1]	TBA Dollar Roll Income	Interest Expense	Net Interest Component of Interest Rate Swaps	Subtotal	Average Interest Earnings Assets	Average TBA Contract Balances	Subtotal	Net Interest Margin (excluding PAA) [1]
Three Months Ended:	(dollars in thousands)								
June 30, 2018	$784,322	62,491	(442,692)	31,475	$435,596	102,193,435	9,407,819	$111,601,254	1.56 %
June 30, 2017	$610,126	81,051	(222,281)	(96,470)	$372,426	83,427,268	14,206,869	$97,634,137	1.53 %
Six Months Ended:									
June 30, 2018	$1,545,414	150,844	(810,113)	(16,685)	$869,460	102,086,239	10,729,080	$112,815,319	1.54 %
June 30, 2017	$1,215,723	151,019	(420,706)	(200,626)	$745,410	84,545,709	12,431,327	$96,977,036	1.54 %

(1) Represents a non-GAAP financial measure. Refer to the "Non-GAAP Financial Measures" section for additional information.

Economic Interest Expense and Average Cost of Interest Bearing Liabilities

Typically, our largest expense is the cost of Interest Bearing Liabilities and the net interest component of interest rate

swaps. The table below shows our average Interest Bearing Liabilities and average cost of Interest Bearing Liabilities as compared to average one-month and average six-month LIBOR for the periods presented.

Cost of Funds on Average Interest Bearing Liabilities

	Average Interest Bearing Liabilities	Interest Bearing Liabilities at Period End	Economic Interest Expense [1]	Average Cost of Interest Bearing Liabilities	Average One-Month LIBOR	Average Six-Month LIBOR	Average One-Month LIBOR Relative to Average Six-Month LIBOR	Average Cost of Interest Bearing Liabilities Relative to Average One-Month LIBOR	Average Cost of Interest Bearing Liabilities Relative to Average Six-Month LIBOR
Three Months Ended:	(dollars in thousands)								
June 30, 2018	$87,103,807	$82,249,834	$411,217	1.89 %	1.97 %	2.50 %	(0.53 %)	(0.08)%	(0.61)%
June 30, 2017	$70,486,779	$69,721,618	$306,533	1.74 %	1.06 %	1.42 %	(0.36)%	0.68 %	0.32 %
Six Months Ended:									
June 30, 2018	$87,240,130	$82,249,834	$826,798	1.90 %	1.81 %	2.30 %	(0.49)%	0.09 %	(0.40)%
June 30, 2017	$71,454,874	$69,721,618	$593,924	1.66 %	0.94 %	1.40 %	(0.46)%	0.72 %	0.26 %

(1) Economic interest expense includes the net interest component of interest rate swaps. Prior to the three months ended March 31, 2018, economic interest expense included the net interest component of interest rate swaps used to hedge cost of funds. Beginning with the three months ended March 31, 2018, as a result of changes to our hedging portfolio, this metric reflects the net interest component of all interest rate swaps.

Economic interest expense increased by $104.7 million to $411.2 million for the three months ended June 30, 2018 compared to the same period in 2017. Economic interest expense increased by $232.9 million to $826.8 million for

the six months ended June 30, 2018 compared to the same period in 2017. The change in each period was primarily due to an increase in average Interest Bearing Liabilities and higher rates on repurchase agreements, partially offset by the

change in the net interest component of interest rate swaps which was $31.5 million for the three months ended June 30, 2018 compared to ($84.3) million for the same period in 2017 and ($16.7) million for the six months ended June 30, 2018 compared to ($173.2) million for the same period in 2017.

We do not manage our portfolio to have a pre-designated amount of borrowings at quarter or year end. Our borrowings at period end are a snapshot of our borrowings as of a date, and this number may differ from average borrowings over the period for a number of reasons. The mortgage-backed securities we own pay principal and interest towards the end of each month and the mortgage-backed securities we purchase are typically settled during the beginning of the month. As a result, depending on the amount of mortgage-backed securities we have committed to purchase, we may retain the principal and interest we receive in the prior month, or we may use it to pay down our borrowings. Moreover, we generally use interest rate swaps, swaptions and other derivative instruments to hedge our portfolio, and as we pledge or receive collateral under these agreements, our borrowings on any given day may be increased or decreased. Our average borrowings during a quarter may differ from period end borrowings as we implement our portfolio management strategies and risk management strategies over changing market conditions by increasing or decreasing leverage. Additionally, these numbers may differ during periods when we conduct equity capital raises, as in certain instances we may purchase additional assets and increase

leverage in anticipation of an equity capital raise. Since our average borrowings and period end borrowings can be expected to differ, we believe our average borrowings during a period provide a more accurate representation of our exposure to the risks associated with leverage than our period end borrowings.

At June 30, 2018 and December 31, 2017, the majority of our debt represented repurchase agreements and other secured financing arrangements collateralized by a pledge of our Residential Investment Securities, residential mortgage loans, commercial real estate investments and corporate loans. All of our Residential Investment Securities are currently accepted as collateral for these borrowings. However, we limit our borrowings, and thus our potential asset growth, in order to maintain unused borrowing capacity and increase the liquidity and strength of our balance sheet.

Realized and Unrealized Gains (Losses)

Realized and unrealized gains (losses) is comprised of net gains (losses) on interest rate swaps, net gains (losses) on disposal of investments, net gains (losses) on other derivatives and net unrealized gains (losses) on instruments measured at fair value through earnings. These components of realized and unrealized gains (losses) for the three and six months ended June 30, 2018 and 2017 were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	(dollars in thousands)			
Net gains (losses) on interest rate swaps [1]	$374,950	$(274,095)	$1,304,909	$(229,067)
Net gains (losses) on disposal of investments	(66,117)	(5,516)	(52,649)	(281)
Net gains (losses) on other derivatives	34,189	(14,423)	(12,956)	(14,104)
Net unrealized gains (losses) on instruments measured at fair value through earnings	(48,376)	16,240	(99,969)	39,923
Total	$294,646	$(277,794)	$1,139,335	$(203,529)

(1) Includes the net interest component of interest rate swaps, realized gains (losses) on termination or maturity of interest rate swaps and unrealized gains (losses) on interest rate swaps.

For the Three Months Ended June 30, 2018 and 2017

Net gains (losses) on interest rate swaps for the three months ended June 30, 2018 was $375.0 million compared to ($274.1) million for the same period in 2017. The change was primarily attributable to the change in unrealized gains (losses) on interest rate swaps which was $343.5 million for the three months ended June 30, 2018 compared to ($177.6) million for the same period in 2017, reflecting a rise in forward interest rates during the three months ended June 30, 2018 compared to a decline in forward interest rates during the same period in 2017.

Net gains (losses) on disposal of investments was ($66.1) million for the three months ended June 30, 2018 compared with ($5.5) million for the same period in 2017. During the three months ended June 30, 2018, we disposed of

Residential Investment Securities with a carrying value of $2.9 billion for an aggregate net loss of ($63.1) million. For the same period in 2017, we disposed of Residential Investment Securities with a carrying value of $2.5 billion for an aggregate net loss of ($5.2) million.

Net gains (losses) on other derivatives was $34.2 million for the three months ended June 30, 2018 compared to ($14.4) million for the same period in 2017. Net gains (losses) on futures contracts was $78.3 million for the three months ended June 30, 2018 compared to ($97.0) million for the same period in 2017. Net gains (losses) on TBA derivatives was ($19.1) million for the three months ended June 30, 2018 compared to $92.9 million for the same period in 2017.

Net unrealized gains (losses) on instruments measured at fair value through earnings was ($48.4) million for the three

months ended June 30, 2018 compared to $16.2 million for the same period in 2017, primarily due to unfavorable changes in unrealized gains (losses) on Agency interest-only investments, non-Agency mortgage-backed securities and credit risk transfer securities, partially offset by favorable changes in unrealized gains (losses) on MSRs for the three months ended June 30, 2018 compared to the same period in 2017.

For the Six Months Ended June 30, 2018 and 2017

Net gains (losses) on interest rate swaps for the six months ended June 30, 2018 was $1.3 billion compared to ($229.1) million for the same period in 2017. The change was primarily attributable to the change in unrealized gains (losses) on interest rate swaps which was $1.3 billion for the six months ended June 30, 2018 compared to ($28.4) million for the same period in 2017, reflecting a rise in forward interest rates during the six months ended June 30, 2018 compared to a decline in forward interest rates during the same period in 2017.

Net gains (losses) on disposal of investments was ($52.6) million for the six months ended June 30, 2018 compared with ($0.3) million for the same period in 2017. During the six months ended June 30, 2018, we disposed of Residential Investment Securities with a carrying value of $3.4 billion for an aggregate net loss of ($50.0) million. For the same period in 2017, we disposed of Residential Investment Securities with a carrying value of $4.6 billion for an aggregate net loss of ($4.0) million and residential mortgage loans for a net loss of ($1.3) million partially offset by a disposal of a wholly-owned triple net leased property for a gain of $5.1 million.

Net gains (losses) on other derivatives was ($13.0) million for the six months ended June 30, 2018 compared to ($14.1) million for the same period in 2017. Net gains (losses) on

futures contracts was $244.8 million for the six months ended June 30, 2018 compared to ($119.7) million for the same period in 2017. Net gains (losses) on TBA derivatives was ($279.1) million for the six months ended June 30, 2018 compared to $115.7 million for the same period in 2017.

Net unrealized gains (losses) on instruments measured at fair value through earnings was ($100.0) million for the six months ended June 30, 2018 compared to $39.9 million for the same period in 2017, primarily due to unfavorable changes in unrealized gains (losses) on Agency interest-only investments, non-Agency mortgage-backed securities and credit risk transfer securities, partially offset by favorable changes in unrealized gains (losses) on MSRs for the six months ended June 30, 2018 compared to the same period in 2017.

Other Income (Loss)

Other income (loss) includes certain revenues and costs associated with our investments in commercial real estate, including rental income and recoveries, net servicing income on MSRs, operating and transaction costs as well as depreciation and amortization expense. We report in Other income (loss) items whose amounts, either individually or in the aggregate, would not, in the opinion of management, be meaningful to readers of the financial statements. Given the nature of certain components of this line item, balances may fluctuate from period to period.

General and Administrative Expenses

General and administrative ("G&A") expenses consist of compensation expense, the management fee and other expenses. The following table shows our total G&A expenses as compared to average total assets and average equity for the periods presented.

G&A Expenses and Operating Expense Ratios

	Total G&A Expenses	Total G&A Expenses/Average Assets [1]	Total G&A Expenses/Average Equity [1]
Three Months Ended:	(dollars in thousands)		
June 30, 2018	$63,781	0.26%	1.84%
June 30, 2017	$54,023	0.25%	1.71%
Six Months Ended:			
June 30, 2018	$126,291	0.25%	1.78%
June 30, 2017	$107,851	0.25%	1.71%

(1) Includes $1.5 million of transaction costs incurred in connection with a securitization of residential whole loans for the six months ended June 30, 2018. Excluding these transaction costs, G&A expenses as a percentage of average total assets were 0.25% and as a percentage of average equity were 1.76% for the six months ended June 30, 2018.

G&A expenses were $63.8 million for the three months ended June 30, 2018, an increase of $9.8 million compared to the same period in 2017. G&A expenses were $126.3 million for the six months ended June 30, 2018, an increase of $18.4 million compared to the same period in 2017. The change in each period was attributable to higher compensation and

management fees, reflecting an increase in adjusted stockholders' equity primarily resulting from the equity capital raised during the second half of 2017. In addition, the the six months ended June 30, 2018 period reflects higher other G&A expenses primarily due to costs incurred in

connection with a securitization of residential whole loans during the first quarter of 2018.

Unrealized Gains and Losses

With our available-for-sale accounting treatment on our Agency mortgage-backed securities, which represent the largest portion of assets on balance sheet, as well as certain commercial mortgage-backed securities, unrealized fluctuations in market values of assets do not impact our GAAP or taxable income but rather are reflected on our balance sheet by changing the carrying value of the asset and

stockholders' equity under accumulated other comprehensive income (loss). As a result of this fair value accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used amortized cost accounting. As a result, comparisons with companies that use amortized cost accounting for some or all of their balance sheet may not be meaningful.

The table below shows cumulative unrealized gains and losses on our available-for-sale investments reflected in the Consolidated Statements of Financial Condition.

	June 30, 2018	December 31, 2017
	(dollars in thousands)	
Unrealized gain	$55,406	$157,818
Unrealized loss	(3,489,853)	(1,283,838)
Net unrealized gain (loss)	$(3,434,447)	$(1,126,020)

Unrealized changes in the estimated fair value of available-for-sale investments may have a direct effect on our potential earnings and dividends: positive changes will increase our equity base and allow us to increase our borrowing capacity while negative changes tend to reduce borrowing capacity . A very large negative change in the net fair value of our available-for-sale Residential Investment Securities might impair our liquidity position, requiring us to sell assets with the likely result of realized losses upon sale.

The fair value of these securities being less than amortized cost at June 30, 2018 is solely due to market conditions and not the quality of the assets. Substantially all of the Agency mortgage-backed securities are "AAA" rated or carry an implied "AAA" rating. The investments are not considered to be other-than-temporarily impaired because we currently have the ability and intent to hold the investments to maturity or for a period of time sufficient for a forecasted market price

recovery up to or beyond the cost of the investments, and it is not more likely than not that we will be required to sell the investments before recovery of the amortized cost bases, which may be maturity. Also, we are guaranteed payment of the principal and interest amounts of the securities by the respective issuing Agency.

Return on Average Equity

Our annualized return (loss) on average equity was 17.20% and 0.46% for the three months ended June 30, 2018 and 2017, respectively. Our annualized return (loss) on average equity was 27.10% and 7.21% for the six months ended June 30, 2018 and 2017, respectively.

The following table shows the components of our annualized return on average equity for the periods presented.

Components of Annualized Return on Average Equity

	Economic Net Interest Income/Average Equity [1]	Realized and Unrealized Gains and Losses/Average Equity [2]	Other Income (Loss)/Average Equity [3]	G&A Expenses/Average Equity	Income Taxes/Average Equity	Return on Average Equity
Three Months Ended:						
June 30, 2018	10.55%	7.59%	0.99%	(1.84%)	(0.09%)	17.20%
June 30, 2017	7.31%	(6.13%)	0.98%	(1.71%)	0.01%	0.46%
Six Months Ended:						
June 30, 2018	11.69%	16.28%	0.96%	(1.78%)	(0.05%)	27.10%
June 30, 2017	8.42%	(0.48%)	0.99%	(1.71%)	(0.01%)	7.21%

(1) Economic net interest income includes the net interest component of interest rate swaps. Prior to the three ended March 31, 2018, economic interest expense included the net interest component of interest rate swaps used to hedge cost of funds. Beginning with the three months ended March 31, 2018, as a result of changes to our hedging portfolio, this metric reflects the net interest component of all interest rate swaps.

(2) Realized and unrealized gains and losses excludes the net interest component of interest rate swaps.

(3) Other income (loss) includes investment advisory income, dividend income from affiliate, and other income (loss).

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Financial Condition

Total assets were $98.8 billion and $101.8 billion at June 30, 2018 and December 31, 2017, respectively. The change was primarily due to a ($4.1) billion decrease in Residential Investment Securities partially offset by a $428.7 million increase in cash, a $259.8 million increase in reverse

repurchase agreements, a $245.0 million increase in corporate debt and a $227.8 million increase in residential mortgage loans. Our portfolio composition, net equity allocation and debt-to-net equity ratio by asset class was as follows at June 30, 2018:

	Residential				Commercial			
	Agency MBS and MSRs	TBAs [1]	CRTs	Non-Agency MBS and Residential Mortgage Loans	CRE Debt & Preferred Equity Investments [2]	Investments in CRE	Corporate Debt	Total [3]
	(dollars in thousands)							
Assets:								
Fair Value/Carrying Value	$87,192,072	$8,180,694	$563,796	$2,672,942	$4,151,059	$477,887	$1,256,276	$96,314,6
Debt:								
Repurchase agreements	74,497,286	8,000,000	335,860	266,774	660,735	—	—	75,760,6
Other secured financing	2,546,975	—	—	937,720	130,000	—	145,792	3,760,48
Securitized debt	—	—	—	374,312	2,354,380	—	—	2,728,69
Net forward purchases	979,049	—	14,557	—	93,500	—	—	1,087,10
Mortgages payable	—	—	—	—	—	309,878	—	309,878
Net Equity Allocated	$9,168,762	$180,694	$213,379	$1,094,136	$912,444	$168,009	$1,110,484	12,667,2
Net Equity Allocated (%)	72 %	1 %	2 %	9 %	7 %	1 %	9 %	100
Debt/Net Equity Ratio	8.5:1	44.3:1	1.6:1	1.4:1	3.5:1	1.8:1	0.1:1	6.0:1

(1) Fair value/carrying value represents implied market value and repurchase agreements represent the notional value.
(2) Includes loans held for sale, net.
(3) Excludes the TBA asset, debt and equity balances.
(4) Net Equity Allocated, as disclosed in the above table, excludes non-portfolio related activity and may differ from stockholders' equity per the Consolidated Statements of Financial Condition.
(5) Represents the debt/net equity ratio as determined using amounts on the Consolidated Statements of Financial Condition.

Residential Investment Securities

Substantially all of our Agency mortgage-backed securities at June 30, 2018 and December 31, 2017 were backed by single-family residential mortgage loans and were secured with a first lien position on the underlying single-family properties. Our mortgage-backed securities were largely Freddie Mac, Fannie Mae or Ginnie Mae pass through certificates or CMOs, which carry an actual or implied "AAA" rating. We carry all of our Agency mortgage-backed securities at fair value on the Consolidated Statements of Financial Condition.

We accrete discount balances as an increase to interest income over the expected life of the related Interest Earning Assets and we amortize premium balances as a decrease to interest income over the expected life of the related Interest Earning Assets. At June 30, 2018 and December 31, 2017 we had on our Consolidated Statements of Financial Condition a total of $142.5 million and $148.3 million, respectively, of unamortized discount (which is the difference between the remaining principal value and current amortized cost of our Residential Investment Securities acquired at a price below

principal value) and a total of $6.0 billion and $6.2 billion, respectively, of unamortized premium (which is the difference between the remaining principal value and the current amortized cost of our Residential Investment Securities acquired at a price above principal value).

The weighted average experienced prepayment speed on our Agency mortgage-backed securities portfolio for the three months ended June 30, 2018 and 2017 was 10.1% and 10.9%, respectively. The weighted average projected long-term prepayment speed on our Agency mortgage-backed securities portfolio as of June 30, 2018 and 2017 was 9.1% and 10.6%, respectively.

Given our current portfolio composition, if mortgage principal prepayment rates were to increase over the life of our mortgage-backed securities, all other factors being equal, our net interest income would decrease during the life of these mortgage-backed securities as we would be required to amortize our net premium balance into income over a shorter time period. Similarly, if mortgage principal prepayment rates were to decrease over the life of our mortgage-backed securities, all other factors being equal, our net interest

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income would increase during the life of these mortgage-backed securities as we would amortize our net premium balance over a longer time period.

The following table summarizes certain characteristics of our Residential Investment Securities (excluding interest-only

mortgage-backed securities) and interest-only mortgage-backed securities at the dates presented.

	June 30, 2018		December 31, 2017	
	(dollars in thousands)			
Residential Investment Securities: [1]				
Principal Amount	$85,921,121		$87,518,155	
Net Premium	4,609,636		4,682,299	
Amortized Cost	90,530,757		92,200,454	
Amortized Cost/Principal Amount	105.36	%	105.35	%
Carrying Value	87,185,951		91,197,901	
Carrying Value / Principal Amount	101.47	%	104.20	%
Weighted Average Coupon Rate	3.73	%	3.69	%
Weighted Average Yield	2.91	%	2.79	%
Adjustable-Rate Residential Investment Securities: [1]				
Principal Amount	$7,042,925		$8,002,252	
Weighted Average Coupon Rate	3.19	%	3.05	%
Weighted Average Yield	2.73	%	2.52	%
Weighted Average Term to Next Adjustment	21 Months		24 Months	
Weighted Average Lifetime Cap [2]	8.06	%	8.12	%
Principal Amount at Period End as % of Total Residential Investment Securities	8.20	%	9.14	%
Fixed-Rate Residential Investment Securities: [1]				
Principal Amount	$78,878,196		$79,515,903	
Weighted Average Coupon Rate	3.78	%	3.75	%
Weighted Average Yield	2.92	%	2.82	%
Principal Amount at Period End as % of Total Residential Investment Securities	91.80	%	90.86	%
Interest-Only Residential Investment Securities:				
Notional Amount	$7,447,116		$7,793,767	
Net Premium	1,287,119		1,342,048	
Amortized Cost	1,287,119		1,342,048	
Amortized Cost/Notional Amount	17.28	%	17.22	%
Carrying Value	977,688		1,102,920	
Carrying Value/Notional Amount	13.13	%	14.15	%
Weighted Average Coupon Rate	3.35	%	3.61	%
Weighted Average Yield	4.03	%	4.17	%

[1] Excludes interest-only mortgage-backed securities.

[2] Excludes non-Agency mortgage-backed securities and CRT securities as this attribute is not applicable to these asset classes.

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The following tables summarize certain characteristics of our Residential Credit portfolio at June 30, 2018.

Product	Estimated Fair Value	Payment Structure		Investment Characteristics					
		Senior	Subordinate	Coupon	Credit Enhancement		60+ Delinquencies	3M VPR [1]	
(dollars in thousands)									
Agency Credit Risk Transfer	$536,768	$—	$536,768	5.34%	1.15	%	0.30 %	6.57	%
Private Label Credit Risk Transfer	27,028	—	27,028	7.78%	3.51	%	1.65 %	6.32	%
Alt-A	170,922	105,461	65,461	4.56%	10.71	%	10.99 %	10.53	%
Prime	264,491	108,641	155,850	4.71%	11.05	%	9.86 %	14.24	%
Subprime	426,449	159,019	267,430	2.91%	9.67	%	18.93 %	5.79	%
Non-Performing Loan Securitizations	3,447	—	3,447	5.00%	48.95	%	52.51 %	2.35	%
Prime Jumbo (>=2010 Vintage)	124,141	98,880	25,261	3.61%	14.45	%	0.13 %	8.63	%
Prime Jumbo (>=2010 Vintage) Interest-Only	17,335	17,335	—	0.45%	—	%	0.18 %	8.95	%
Total/Weighted Average	$1,570,581	$489,336	$1,081,245	4.60%	7.69	%	8.79 %	13.48	%

[1] Represents the 3 month voluntary prepayment rate ("VPR").

Market Value By Sector and Bond Coupon

Product	ARM	Fixed	Floater	Interest-Only	Estimated Fair Value
(dollars in thousands)					
Agency Credit Risk Transfer	$—	$—	$536,768	$ —	$536,768
Private Label Credit Risk Transfer	—	—	27,028	—	27,028
Alt-A	48,614	96,578	25,730	—	170,922
Prime	145,837	118,654	—	—	264,491
Subprime	—	47,190	379,259	—	426,449
Non-Performing Loan Securitizations	—	3,447	—	—	3,447
Prime Jumbo (>=2010 Vintage)	—	124,141	—	—	124,141
Prime Jumbo (>=2010 Vintage) Interest-Only	—	—	—	17,335	17,335
Total	$194,451	$390,010	$968,785	$ 17,335	$1,570,581

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Contractual Obligations

The following table summarizes the effect on our liquidity and cash flows from contractual obligations at June 30, 2018. The table does not include the effect of net interest component of our interest rate swaps. The net swap payments will

fluctuate based on monthly changes in the receive rate. At June 30, 2018, the interest rate swaps had a net fair value of ($293.6) million.

	Within One Year	One to Three Years	Three to Five Years	More than Five Years	Total
	(dollars in thousands)				
Repurchase agreements	$75,760,655	$—	$—	$—	$75,760,655
Interest expense on repurchase agreements [1]	333,590	—	—	—	333,590
Other secured financing	2,915	3,611,780	145,792	—	3,760,487
Interest expense on other secured financing [1]	94,465	143,568	3,358	—	241,391
Securitized debt of consolidated VIEs (principal)	—	—	1,882,640	819,857	2,702,497
Interest expense on securitized debt of consolidated VIEs	73,092	146,185	118,652	320,182	658,111
Mortgages payable (principal)	11,025	12,350	—	289,125	312,500
Interest expense on mortgages payable	13,243	24,847	24,746	26,716	89,552
Long-term operating lease obligations	3,267	7,340	7,723	9,012	27,342
Total	$76,292,252	$3,946,070	$2,182,911	$1,464,892	$83,886,125

[1] Interest expense on repurchase agreements and other secured financing calculated based on rates at June 30, 2018.

In the coming periods, we expect to continue to finance our Residential Investment Securities in a manner that is largely consistent with our current operations via repurchase agreements. We may use FHLB Des Moines advances, securitization structures, mortgages payable or other term financing structures to finance certain of our assets. During the six months ended June 30, 2018, we received $5.7 billion from principal repayments and $3.4 billion in cash from disposal of Residential Investment Securities, respectively. During the six months ended June 30, 2017, we received $5.8 billion from principal repayments and $4.6 billion in cash from disposal of Residential Investment Securities.

Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships which would have been established for the sole purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

We have limited future funding commitments related to certain of our unconsolidated joint ventures. In addition, the Company has provided customary non-recourse carve-out and environmental guarantees (or underlying indemnities with respect thereto) with respect to mortgage loans held by subsidiaries of these unconsolidated joint ventures. We believe that the likelihood of making any payments under these guarantees is remote, and have not accrued a related liability at June 30, 2018.

Capital Management

Maintaining a strong balance sheet that can support the business even in times of economic stress and market

volatility is of critical importance to our business strategy. A strong and robust capital position is essential to executing our investment strategy. Our capital strategy is predicated on a strong capital position, which enables us to execute our investment strategy regardless of the market environment.

Our Internal Capital Adequacy Assessment Program ("ICAAP") framework supports capital measurement, and is integrated within the overall risk governance framework. The ICAAP framework is designed to align capital measurement with our risk appetite.

Our capital policy defines the parameters and principles supporting a comprehensive capital management practice, including processes that effectively identify, measure and monitor risks impacting capital adequacy. Our capital assessment process considers the precision in risk measures as well as the volatility of exposures and the relative activities producing risk. Parameters used in modeling economic capital must align with our risk appetite.

The major risks impacting capital are liquidity, investment/market, credit, counterparty, operational and compliance, regulatory and legal risks. For further discussion of the risks we are subject to, please see Part I, Item 1A. "Risk Factors" in our most recent Annual Report on Form 10-K and Item 1A. "Risk Factors" in quarterly reports on Form 10-Q.

Capital requirements are based on maintaining levels above approved limits, ensuring the quality of our capital appropriately reflects our asset mix, market and funding structure. As such we use a complement of capital metrics and related threshold levels to measure and analyze our capital from a magnitude and composition perspective. Our policy is to maintain an appropriate amount of available

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financial resources over the aggregate economic capital requirements.

Available Financial Resources is the actual capital held to protect against the unexpected losses measured in our capital management process and may include:

- Common and preferred equity
- Other forms of equity-like capital
- Surplus credit reserves over expected losses
- Other loss absorption instruments

In the event we fall short of our internal limits, we will consider appropriate actions which may include asset sales, changes in asset mix, reductions in asset purchases or originations, issuance of capital or other capital enhancing or risk reduction strategies.

Stockholders' Equity

The following table provides a summary of total stockholders' equity at June 30, 2018 and December 31, 2017:

	June 30, 2018	December 31, 2017
Stockholders' Equity:	(dollars in thousands)	
7.625% Series C Cumulative Redeemable Preferred Stock	$169,466	$290,514
7.50% Series D Cumulative Redeemable Preferred Stock	445,457	445,457
7.625% Series E Cumulative Redeemable Preferred Stock	—	287,500
6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	696,910	696,910
6.50% Series G Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	411,335	—
Common stock	11,643	11,596
Additional paid-in capital	17,268,596	17,221,265
Accumulated other comprehensive income (loss)	(3,434,447)	(1,126,020)
Accumulated deficit	(1,800,370)	(2,961,749)
Total stockholders' equity	$13,768,590	$14,865,473

Common and Preferred Stock

The following table provides a summary of options activity for the periods presented:

	Options Exercised	Aggregate Exercise Price	Shares Issued Through Direct Purchase	Amount Raised from Direct Purchase and Dividend Reinvestment Program
Six Months Ended:		(dollars in thousands)		
June 30, 2018	—	$—	147,000	$ 1,546
June 30, 2017	—	$—	113,000	$ 1,270

During the six months ended June 30, 2018, we issued 4.6 million shares under the at-the-market sales program for proceeds of $48.2 million, net of commissions and fees.

In July 2018, we issued an additional 2.3 million shares under the at-the-market sales program for proceeds of $23.7 million, net of commissions and fees.

Leverage and Capital

We believe that it is prudent to maintain conservative debt-to-equity and economic leverage ratios as there continues to be volatility in the mortgage and credit markets. Our capital policy governs our capital and leverage position including setting limits. Based on the guidelines, we generally expect to maintain an economic leverage ratio of less than 10:1. Our actual economic leverage ratio varies from time to time based upon various factors, including our Manager's opinion of the level of risk of our assets and liabilities, our liquidity position,

our level of unused borrowing capacity, the availability of credit, over-collateralization levels required by lenders when we pledge assets to secure borrowings and our assessment of domestic and international market conditions.

Our debt-to-equity ratio at June 30, 2018 and December 31, 2017 was 6.0:1 and 5.7:1, respectively. Our economic leverage ratio, which is computed as the sum of Recourse Debt, TBA derivative notional outstanding and net forward purchases of investments divided by total equity, at June 30, 2018 and December 31, 2017 was 6.4:1 and 6.6:1, respectively. Our capital ratio, which represents our ratio of stockholders' equity to total assets (inclusive of total market value of TBA derivatives and exclusive of securitized debt of consolidated VIEs), was 13.2% and 12.9% at June 30, 2018 and December 31, 2017, respectively.

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Risk Management

We are subject to a variety of risks in the ordinary conduct of our business. The effective management of these risks is of critical importance to the overall success of Annaly. The objective of our risk management framework is to identify, measure, monitor and manage these risks.

Our risk management framework is intended to facilitate a holistic, enterprise wide view of risk. We have built a strong and collaborative risk management culture throughout Annaly focused on awareness which ensures the key risks are understood and managed appropriately. Each employee of our Manager is accountable for monitoring and managing risk within their area of responsibility.

Risk Appetite

We maintain a firm-wide risk appetite statement which defines the types and levels of risk we are willing to take in order to achieve our business objectives, and reflects our risk management philosophy. We engage in risk activities based on our core expertise that aim to enhance value for our stockholders. Our activities focus on capital preservation and income generation through proactive portfolio management, supported by a conservative liquidity and leverage posture.

The risk appetite statement asserts the following key risk parameters to guide our investment management activities:

Risk Parameter	Description
Portfolio Composition	We will maintain a portfolio comprised of target assets approved by our Board and in accordance with our capital allocation policy.
Leverage	We will operate at an economic leverage ratio no greater than 10:1.
Liquidity Risk	We will seek to maintain an unencumbered asset portfolio sufficient to meet our liquidity needs under adverse market conditions.
Interest Rate Risk	We will seek to manage interest rate risk to protect the portfolio from adverse rate movements utilizing derivative instruments targeting both income and capital preservation.
Credit Risk	We will seek to manage credit risk by making investments which conform within our specific investment policy parameters and optimize risk-adjusted returns.
Capital Preservation	We will seek to protect our capital base through disciplined risk management practices.
Compliance	We will comply with regulatory requirements needed to maintain our REIT status and our exemption from registration under the Investment Company Act.

Governance

Risk management begins with our Board, through the review and oversight of the risk management framework, and executive management, through the ongoing formulation of risk management practices and related execution in managing risk. The Board exercises its oversight of risk management primarily through the Board Risk Committee ("BRC") and Board Audit Committee ("BAC"). The BRC is responsible for oversight of our risk governance structure, risk management and risk assessment guidelines and policies and our risk appetite. The BAC is responsible for oversight of the quality and integrity of our accounting, internal controls and financial reporting practices, including independent auditor selection, evaluation and review, and oversight of the internal audit function.

Risk assessment and risk management are the responsibility of our management. A series of management committees have oversight or decision-making responsibilities for risk management activities. Membership of these committees is reviewed regularly to ensure the appropriate personnel are engaged in the risk management process. Four primary management committees have been established to provide a comprehensive framework for risk management.

The management committees responsible for our risk management include the Enterprise Risk Committee (“ERC”), Asset and Liability Committee (“ALCO”), Investment Committee and the Financial Reporting and Disclosure Committee (“FRDC”). Each of these committees reports to our management Operating Committee which is responsible for oversight and management of our operations, including oversight and approval authority over all aspects of our enterprise risk management.

Audit Services is an independent function with reporting lines to the BAC. Audit Services is responsible for performing our internal audit activities, which includes independently assessing and validating key controls within the risk management framework.

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Description of Risks

We are subject to a variety of risks due to the business we operate. Risk categories are an important component of a robust enterprise wide risk management framework.

We have identified the following primary categories that we utilize to identify, assess, measure and monitor risk.

Risk	Description
Capital, Liquidity and Funding Risk	Risk to earnings, capital or business arising from our inability to meet our obligations when they come due without incurring unacceptable losses because of inability to liquidate assets or obtain adequate funding.
Investment/Market Risk	Risk to earnings, capital or business resulting in the decline in value of our assets or an increase in the costs of financing caused by changes in market variables, such as interest rates, which affect the values of investment securities and other investment instruments.
Credit Risk	Risk to earnings, capital or business resulting from an obligor's failure to meet the terms of any contract or otherwise failure to perform as agreed. This risk is present in lending and investing activities.
Counterparty Risk	Risk to earnings, capital or business resulting from a counterparty's failure to meet the terms of any contract or otherwise failure to perform as agreed. This risk is present in funding, hedging and investing activities.
Operational Risk	Risk to earnings, capital, reputation or business arising from inadequate or failed internal processes or systems, human factors or external events. Model risk is included in operational risk.
Compliance, Regulatory and Legal Risk	Risk to earnings, capital, reputation or conduct of business arising from violations of, or nonconformance with internal and external applicable rules and regulations, losses resulting from lawsuits or adverse judgments, or from changes in the regulatory environment that may impact our business model.

Capital, Liquidity and Funding Risk Management

Our capital, liquidity and funding risk management strategy is designed to ensure the availability of sufficient resources to support our business and meet our financial obligations under both normal and adverse market and business

environments. Our capital, liquidity and funding risk management practices consist of the following primary elements:

Element	Description
Funding	Availability of diverse and stable sources of funds.
Excess Liquidity	Excess liquidity primarily in the form of unencumbered assets.
Maturity Profile	Diversity and tenor of liabilities and modest use of leverage.
Stress Testing	Scenario modeling to measure the resiliency of our liquidity position.
Liquidity Management Policies	Comprehensive policies including monitoring, risk limits and an escalation protocol.

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Funding

Our primary financing sources are repurchase agreements provided through counterparty arrangements and through Arcola, other secured financing including funding from the Federal Home Loan Bank ("FHLB"), securitized debt, mortgages, credit facilities, note sales and various forms of equity. We maintain excess liquidity by holding unencumbered liquid assets that could be either sold or used to collateralize additional borrowings.

We seek to conservatively manage our repurchase agreement funding position through a variety of methods including diversity, breadth and depth of counterparties and maintaining a staggered maturity profile.

Additionally, our wholly-owned subsidiary, Arcola, provides direct access to third party funding as a FINRA member broker-dealer. Arcola borrows funds through the General Collateral Finance Repo service offered by the Fixed Income Clearing Corporation ("FICC"), with FICC acting as the central counterparty. Arcola may also borrow funds through other repurchase agreements.

To reduce our liquidity risk we maintain a laddered approach to our repurchase agreements. At June 30, 2018, the weighted average days to maturity was 71 days.

Our repurchase agreements generally provide that in the event of a margin call we must provide additional securities or cash on the same business day that a margin call is made. Should prepayment speeds on the mortgages underlying our Agency and Residential mortgage-backed securities and/or market interest rates or other factors move suddenly and cause declines in the market value of assets posted as collateral, resulting margin calls may cause an adverse change in our liquidity position.

We maintain access to FHLB funding through our captive insurance subsidiary Truman Insurance Company LLC ("Truman"). We finance eligible Agency, residential credit and commercial investments through the FHLB. A rule from the Federal Housing Finance Agency ("FHFA") requires captive insurance companies to terminate their FHLB membership, however, given the length of its membership, Truman was granted a five year sunset provision whereby its membership will expire in February 2021. We believe our business objectives align well with the mission of the FHLB System. While there can be no assurances that such steps will be taken, we believe it would be appropriate for there to be legislative or other action to permit Truman and similar captive insurance subsidiaries to retain their membership status beyond the current sunset period.

We utilize diverse funding sources to finance our commercial investments. Aside from FHLB funding, we may utilize credit facilities, securitization funding and, in the case of investments in commercial real estate, mortgage financing and note sales.

At June 30, 2018, we had total financial assets and cash pledged against existing liabilities of $88.5 billion. The weighted average haircut was approximately 4% on repurchase agreements. The quality and character of the Residential Investment Securities and commercial real estate investments that we pledge as collateral under the repurchase agreements and interest rate swaps did not materially change at June 30, 2018 compared to December 31, 2017, and our counterparties did not materially alter any requirements, including required haircuts, related to the collateral we pledge under repurchase agreements and interest rate swaps during the three months ended June 30, 2018.

The following table presents our quarterly average and quarter-end repurchase agreement and reverse repurchase agreement balances outstanding for the periods presented:

	Repurchase Agreements		Reverse Repurchase Agreements	
	Average Daily Amount Outstanding	Ending Amount Outstanding	Average Daily Amount Outstanding	Ending Amount Outstanding
Three Months Ended:	(dollars in thousands)			
June 30, 2018	$80,582,681	$75,760,655	$2,929,470	$ 259,762
March 31, 2018	80,770,663	78,015,431	2,064,862	200,459
December 31, 2017	78,755,896	77,696,343	1,295,652	—
September 30, 2017	69,314,576	69,430,268	994,565	—
June 30, 2017	63,191,827	62,497,400	474,176	—
March 31, 2017	64,961,511	62,719,087	1,738,333	—
December 31, 2016	64,484,326	65,215,810	1,064,130	—
September 30, 2016	63,231,246	61,784,121	1,494,022	—
June 30, 2016	54,647,175	53,868,385	1,159,341	—

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The following table provides information on our repurchase agreements and other secured financing by maturity date at June 30, 2018. The weighted average remaining maturity on our repurchase agreements and other secured financing was 111 days at June 30, 2018:

June 30, 2018	Principal Balance	June 30, 2018 Weighted Average Rate	% of Total
	(dollars in thousands)		
1 day	$—	— %	— %
2 to 29 days	30,922,430	2.15 %	38.9 %
30 to 59 days	6,328,941	2.11 %	8.0 %
60 to 89 days	14,275,263	2.15 %	18.0 %
90 to 119 days	9,278,603	2.08 %	11.7 %
Over 120 days [1]	18,715,905	2.35 %	23.4 %
Total	$79,521,142	2.18 %	100.0 %

[1] Approximately 5% of the total repurchase agreements and other secured financing had a remaining maturity over 1 year.

The table below presents our outstanding debt balances and associated weighted average rates and days to maturity at June 30, 2018:

	Principal Balance	Weighted Average Rate At Period End	Weighted Average Rate For the Quarter	Weighted Average Days to Maturity [1]
	(dollars in thousands)			
Repurchase agreements	$75,760,655	2.17 %	1.99 %	71
Other secured financing [2]	3,760,487	2.48 %	2.57 %	924
Securitized debt of consolidated VIEs [3]	2,702,497	2.70 %	2.62 %	3,199
Mortgages payable [3]	312,500	4.24 %	4.36 %	2,407
Total indebtedness	$82,536,139			

[1] Determined based on estimated weighted-average lives of the underlying debt instruments.
[2] Includes advances from the Federal Home Loan Bank of Des Moines of $3.6 billion and financing under credit facilities.
[3] Non-recourse to Annaly.

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Excess Liquidity

Our primary source of liquidity is the availability of unencumbered assets which may be provided as collateral to support additional funding needs. We target minimum thresholds of available, unencumbered assets to maintain excess liquidity. The following table illustrates our asset portfolio available to support potential collateral obligations and funding needs.

Assets are considered encumbered if pledged as collateral against an existing liability, and therefore are no longer available to support additional funding. An asset is considered unencumbered if it has not been pledged or securitized. The following table also provides the carrying amount of our encumbered and unencumbered financial assets at June 30, 2018:

	Encumbered Assets	Unencumbered Assets	Total
	(dollars in thousands)		
Financial Assets:			
Cash and cash equivalents	$1,042,671	$ 92,658	$1,135,329
Investments, at carrying value: [1]			
Agency mortgage-backed securities	80,997,975	4,542,820	85,540,795
Credit risk transfer securities	417,403	136,793	554,196
Non-Agency mortgage-backed securities	435,877	570,908	1,006,785
Residential mortgage loans	1,608,935	57,222	1,666,157
MSRs	4,164	594,850	599,014
Commercial real estate debt investments	2,733,405	124,058	2,857,463
Commercial real estate debt and preferred equity, held for investment	652,897	598,241	1,251,138
Loans held for sale, net	—	42,458	42,458
Corporate debt	642,016	614,260	1,256,276
Total financial assets	$88,535,343	$ 7,374,268	$95,909,611

(1) The amounts reflected in the table above are on a settlement date basis and may differ from the total positions reported on the Consolidated Statements of Financial Condition.

We maintain liquid assets in order to satisfy our current and future obligations in normal and stressed operating environments. These are held as the primary means of liquidity risk mitigation. The composition of our liquid assets is also considered and is subject to certain parameters. The composition is monitored for concentration risk and asset type. We believe the assets we consider liquid can be readily converted into cash, through liquidation or by being used as

collateral in financing arrangements (including as additional collateral to support existing financial arrangements). Our balance sheet also generates liquidity on an on-going basis through mortgage principal and interest repayments and net earnings held prior to payment of dividends. The following table presents our liquid assets as a percentage of total assets at June 30, 2018.

Liquid Assets	Carrying Value [1] (dollars in thousands)
Cash and cash equivalents	$1,135,329
Residential Investment Securities [2]	87,101,776

Residential mortgage loans [3]	1,143,178	
Commercial real estate debt investments [4]	315,050	
Commercial real estate debt and preferred equity, held for investment	921,997	
Loans held for sale, net	42,458	
Corporate debt	772,114	
Total liquid assets	$91,431,902	
Percentage of liquid assets to carrying amount of encumbered and unencumbered financial assets [3][4]	98.48	%

(1) Carrying value approximates the market value of assets. The assets listed in this table include $86.0 billion of assets that have been pledged as collateral against existing liabilities at June 30, 2018. Please refer to the Encumbered and Unencumbered Assets table for related information.

(2) The amounts reflected in the table above are on a settlement date basis and may differ from the total positions reported on the Consolidated Statements of Financial Condition.

(3) Excludes securitized residential mortgage loans transferred or pledged to consolidated VIEs carried at fair value of $523.0 million.

(4) Excludes senior securitized commercial mortgage loans of consolidated VIEs carried at fair value of $2.5 billion.

Maturity Profile

We consider the profile of our assets, liabilities and derivatives when managing both liquidity risk as well as investment/market risk employing a measurement of both the maturity gap and interest rate sensitivity gap.

We determine the amount of liquid assets that are required to be held by monitoring several liquidity metrics. We utilize several modeling techniques to analyze our current and potential obligations including the expected cash flows from our assets, liabilities and derivatives. The following table illustrates the expected final maturities and cash flows of our assets, liabilities and derivatives. The table is based on a static portfolio and assumes no reinvestment of asset cash flows and no future liabilities are entered into. In assessing the maturity of our assets, liabilities and off balance sheet obligations, we use the stated maturities, or our prepayment expectations for assets and liabilities that exhibit prepayment characteristics. Cash and cash equivalents are included in the 'Less than 3 Months' maturity bucket, as they are typically held for a short period of time.

With respect to each maturity bucket, our maturity gap is considered negative when the amount of maturing liabilities exceeds the amount of maturing assets. A negative gap increases our liquidity risk as we must enter into future liabilities.

Our interest rate sensitivity gap is the difference between Interest Earning Assets and Interest Bearing Liabilities maturing or re-pricing within a given time period. Unlike the

calculation of maturity gap, interest rate sensitivity gap includes the effect of our interest rate swaps. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities. A gap is considered negative when the amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in overall market rates or conditions, changes in interest rates may affect net interest income positively or negatively even if assets and liabilities were perfectly matched in each maturity category. The amount of assets and liabilities utilized to compute our interest rate sensitivity gap was determined in accordance with the contractual terms of the assets and liabilities, except that adjustable-rate loans and securities are included in the period in which their interest rates are first scheduled to adjust and not in the period in which they mature. The effects of interest rate swaps, whereby we generally pay a fixed rate and receive a floating rate and effectively lock in our financing costs for a longer term, are also reflected in our interest rate sensitivity gap. The interest rate sensitivity of our assets and liabilities in the following table at June 30, 2018 could vary substantially based on actual prepayment experience.

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	Less than 3 Months	3-12 Months	More than 1 Year to 3 Years	3 Years and Over	Total
Financial Assets:	(dollars in thousands)				
Cash and cash equivalents	$1,135,329	$—	$—	$—	$1,135,329
Agency mortgage-backed securities (principal)	—	—	2,837,663	81,508,805	84,346,468
Credit risk transfer securities (principal)	—	5,728	20,000	503,141	528,869
Non-Agency mortgage-backed securities (principal)	—	—	100,892	944,892	1,045,784
Residential mortgage loans (principal)	—	—	—	1,658,358	1,658,358
Commercial real estate debt investments (principal)	—	—	—	2,842,310	2,842,310
Commercial real estate debt and preferred equity (principal)	15,187	345,856	713,356	182,424	1,256,823
Corporate debt (principal)	—	—	61,810	1,205,166	1,266,976
Reverse repurchase agreements	259,762	—	—	—	259,762
Total financial assets - maturity	1,410,278	351,584	3,733,721	88,845,096	94,340,679
Effect of utilizing reset dates [1]	6,662,423	2,847,883	(1,684,108)	(7,826,198)	
Total financial assets - interest rate sensitive	$8,072,701	$3,199,467	$2,049,613	$81,018,898	$94,340,679
Financial Liabilities:					
Repurchase agreements	$53,372,845	$22,387,810	$—	$—	$75,760,655
Other secured financing	—	2,915	3,682,518	75,054	3,760,487
Securitized debt of consolidated VIE (principal)	—	—	—	2,702,497	2,702,497
Total financial liabilities - maturity	53,372,845	22,390,725	3,682,518	2,777,551	82,223,639
Effect of utilizing reset dates [1][2]	(55,411,651)	13,276,366	12,954,336	29,180,949	
Total financial liabilities - interest rate sensitive	$(2,038,806)	$35,667,091	$16,636,854	$31,958,500	$82,223,639
Maturity gap	$(51,962,567)	$(22,039,141)	$51,203	$86,067,545	$12,117,040
Cumulative maturity gap	$(51,962,567)	$(74,001,708)	$(73,950,505)	$12,117,040	
Interest rate sensitivity gap	$10,111,507	$(32,467,624)	$(14,587,241)	$49,060,398	$12,117,040
Cumulative rate sensitivity gap	$10,111,507	$(22,356,117)	$(36,943,358)	$12,117,040	

[1] Maturity gap utilizes stated maturities, or prepayment expectations for assets that exhibit prepayment characteristics, while interest rate sensitivity gap utilizes reset dates, if applicable.
[2] Includes effect of interest rate swaps.

The methodologies we employ for evaluating interest rate risk include an analysis of our interest rate "gap," measurement of the duration and convexity of our portfolio and sensitivities to interest rates and spreads.

Stress Testing

We utilize liquidity stress testing to ensure we have sufficient liquidity under a variety of scenarios and stresses. These stress tests assist with the management of our pool of liquid assets and influence our current and future funding plans. Our stress tests are modeled over both short term and longer time horizons. The stresses applied include market-wide and firm-specific stresses.

Liquidity Management Policies

We utilize a comprehensive liquidity policy structure to inform our liquidity risk management practices including monitoring and measurement, along with well-defined key limits. Both quantitative and qualitative targets are utilized

to measure the ongoing stability and condition of the liquidity position, and include the level and composition of unencumbered assets, as well as both short-term and long-term sustainability of the funding composition under stress conditions.

We also monitor early warning metrics designed to measure the quality and depth of liquidity sources based upon both company-specific and market conditions. The metrics assist in assessing our liquidity conditions and are integrated into our escalation protocol, with various liquidity ratings influencing management actions with respect to contingency planning and potential related actions.

Investment/Market Risk Management

One of the primary risks we are subject to is investment/market risk. Changes in the level of interest rates can affect our net interest income, which is the difference between the income we earn on our Interest Earning Assets and the interest expense incurred from Interest Bearing Liabilities and

derivatives. Changes in the level of interest rates and spreads can also affect the value of our securities and potential realization of gains or losses from the sale of these assets. We may utilize a variety of financial instruments, including interest rate swaps, swaptions, options, futures and other hedges, in order to limit the adverse effects of interest rates on our results. In the case of interest rate swaps, we may use
market agreed coupon ("MAC") interest rate swaps in which we may receive or make a payment at the time of entering such interest rate swap to compensate for the off-market nature of such interest rate swap. MAC interest rate swaps offer increased liquidity and more efficient portfolio administration through compression which is the process of reducing the number of unique interest rate swap contracts and replacing them with fewer contracts containing market defined terms. Our portfolio and the value of our portfolio, including derivatives, may be adversely affected as a result of changing interest rates and spreads.

We simulate a wide variety of interest rate scenarios in evaluating our risk. Scenarios are run to capture our sensitivity to changes in interest rates, spreads and the shape of the yield curve. We also consider the assumptions affecting our analysis such as those related to prepayments. In addition

to predefined interest rate scenarios, we utilize Value-at-Risk measures to estimate potential losses in the portfolio over various time horizons utilizing various confidence levels. The following tables estimate the potential changes in economic net interest income over a twelve month period and the immediate effect on our portfolio market value (inclusive of derivative instruments), should interest rates instantaneously increase or decrease by 25, 50 or 75 basis points, and the effect of portfolio market value if mortgage option-adjusted spreads instantaneously increase or decrease by 5, 15 or 25 basis points (assuming shocks are parallel and instantaneous). All changes to income and portfolio market value are measured as percentage changes from the projected net interest income and portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at June 30, 2018. The net interest income simulations incorporate the interest expense effect of rate resets on liabilities and derivatives as well as the amortization expense and reinvestment of principal based on the prepayments on our securities, which varies based on the level of rates. The results assume no management actions in response to the rate or spread changes. The following table presents estimates at June 30, 2018. Actual results could differ materially from these estimates.

Change in Interest Rate [1]	Projected Percentage Change in Economic Net Interest Income [2]	Estimated Percentage Change in Portfolio Value [3]	Estimated Change as a % on NAV [3][4]
-75 Basis Points	(15.3%)	0.2%	1.8%
-50 Basis Points	(8.0%)	0.3%	2.0%
-25 Basis Points	(2.7%)	0.2%	1.3%
Base Interest Rate	—	—	—
+25 Basis Points	1.7%	(0.3%)	(1.9%)
+50 Basis Points	2.1%	(0.6%)	(4.2%)
+75 Basis Points	2.0%	(0.9%)	(7.0%)

MBS Spread Shock [1]	Estimated Change in Portfolio Market Value	Estimated Change as a % on NAV [3][4]
-25 Basis Points	1.5%	11.5%
-15 Basis Points	0.9%	6.8%
-5 Basis Points	0.3%	2.3%
Base Interest Rate	—	—
+5 Basis Points	(0.3%)	(2.3%)
+15 Basis Points	(0.9%)	(6.7%)

+25 Basis Points	(1.5%)	(11.2%)

(1) Interest rate and MBS spread sensitivity are based on results from third party models in conjunction with inputs from our internal investment professionals. Actual results could differ materially from these estimates.

(2) Scenarios include Residential Investment Securities, commercial real estate investments, corporate debt, repurchase agreements, other secured financing and interest rate swaps. Economic net interest income includes the net interest component of interest rate swaps.

(3) Scenarios include Residential Investment Securities, residential mortgage loans, MSRs and derivative instruments.

(4) NAV represents book value of equity.

Credit Risk Management

Key risk parameters have been established to specify our credit risk appetite. We will seek to manage credit risk by making investments which conform within the firm’s specific investment policy parameters and optimize risk-return attributes.

While we do not expect to encounter credit risk in our Agency investments, we face credit risk on the non-Agency mortgage-backed securities and CRT securities in our portfolio. In addition, we are also exposed to credit risk on residential mortgage loans, commercial real estate investments and corporate debt. MSR values may also be impacted if overall costs to service the underlying mortgage

loans increase due to borrower performance. We are subject to risk of loss if an issuer or borrower fails to perform its contractual obligations. We have established policies and procedures for mitigating credit risk, including establishing and reviewing limits for credit exposure. We will originate or purchase commercial investments that meet our comprehensive underwriting process and credit standards and are approved by the appropriate committee. Once a

commercial investment is made, our ongoing surveillance process includes regular reviews, analysis and oversight of investments by our investment personnel and appropriate committee. We review credit and other risks of loss associated with each investment. Our management monitors the overall portfolio risk and determines estimates of provision for loss. Our portfolio composition at June 30, 2018 and December 31, 2017 was as follows:

Asset Portfolio (using balance sheet values)

Category	June 30, 2018		December 31, 2017	
Agency mortgage-backed securities	89.9	%	90.6	%
Credit risk transfer securities	0.6	%	0.7	%
Non-Agency mortgage-backed securities	1.1	%	1.1	%
Residential mortgage loans	1.7	%	1.4	%
Mortgage servicing rights	0.6	%	0.6	%
Commercial real estate [(1)]	4.8	%	4.6	%
Corporate debt	1.3	%	1.0	%

[(1)] Net of unamortized origination fees.

Counterparty Risk Management

Our use of repurchase and derivative agreements and trading activities create exposure to counterparty risk relating to potential losses that could be recognized if the counterparties to these agreements fail to perform their obligations under the contracts. In the event of default by a counterparty, we could have difficulty obtaining our assets pledged as collateral. A significant portion of our investments are financed with repurchase agreements by pledging our Residential Investment Securities and certain commercial real estate investments as collateral to the lender. The collateral we pledge generally exceeds the amount of the borrowings under each agreement. If the counterparty to the repurchase agreement defaults on its obligations and we are not able to recover our pledged asset, we are at risk of losing the over-collateralization or haircut. The amount of this exposure is the difference between the amount loaned to us plus interest due to the counterparty and the fair value of the collateral pledged by us to the lender including accrued interest receivable on such collateral.

We also use interest rate swaps and other derivatives to manage interest rate risk. Under these agreements, we pledge securities and cash as collateral or settle variation margin payments as part of a margin arrangement.

If a counterparty were to default on its obligations, we would be exposed to a loss to a derivative counterparty to the extent that the amount of our securities or cash pledged exceeded the unrealized loss on the associated derivative and we were not able to recover the excess collateral. Additionally, we would be exposed to a loss to a derivative counterparty to the extent that our unrealized gains on derivative instruments exceeded the amount of the counterparty's securities or cash pledged to us.

We monitor our exposure to counterparties across several dimensions including by type of arrangement, collateral type, counterparty type, ratings and geography.

The following table summarizes our exposure to counterparties by geography at June 30, 2018:

Country	Number of Counterparties	Repurchase Agreement Financing	Interest Rate Swaps at Fair Value	Exposure [1]
		(dollars in thousands)		
North America	33	$53,980,782	$(117,504)	$2,247,252
Europe	13	16,555,183	(176,144)	1,496,257
Asia (non-Japan)	1	441,947	—	24,638
Japan	4	4,782,743	—	278,810
Total	51	$75,760,655	$(293,648)	$4,046,957

(1) Represents the amount of cash and/or securities pledged as collateral to each counterparty less the aggregate of repurchase agreement financing and unrealized loss on swaps for each counterparty.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
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Operational Risk Management

We are subject to operational risk in each of our business and support functions. Operational risk may arise from internal or external sources including human error, fraud, systems issues, process change, vendors, business interruptions and other external events. Model risk considers potential errors with a model's results due to uncertainty in model parameters and inappropriate methodologies used. The result of these risks may include financial loss and reputational damage. We manage operational risk through a variety of tools including policies and procedures that cover topics such as business continuity, personal conduct, cybersecurity and vendor management. Other tools include testing, including disaster recovery testing; systems controls, including access controls; training, including cybersecurity awareness training; and monitoring, which includes the use of key risk indicators. Employee level lines of defense against operational risk include proper segregation of incompatible duties, activity-level internal controls over financial reporting, the empowerment of business units to identify and mitigate operational risk sources, testing by our internal audit staff, and our overall governance framework.

We have established a Cybersecurity Committee to help mitigate cybersecurity risks. The role of the committee is to oversee cyber risk assessments, monitor applicable key risk indicators, review cybersecurity training procedures, oversee the Company's Cybersecurity Incident Response Plan and engage third parties to conduct periodic penetration testing. Our cybersecurity risk assessment includes an evaluation of cyber risk related to sensitive data held by third parties on their systems. The Cybersecurity Committee periodically reports to the ERC, the BRC and the BAC. There is no assurance that these efforts will effectively mitigate cybersecurity risk and mitigation efforts are not an assurance that no cybersecurity incidents will occur. We have purchased cybersecurity insurance, however, there is no assurance that the insurance policy will cover all cybersecurity breaches or that the policy will cover all losses.

Compliance, Regulatory and Legal Risk Management

Our business is organized as a REIT, and we plan to continue to meet the requirements for taxation as a REIT. The determination that we are a REIT requires an analysis of various factual matters and circumstances. Accordingly, we closely monitor our REIT status within our risk management program.

The financial services industry is highly regulated and continues to receive increasing attention from regulators, which may impact both our company as well as our business strategy. We proactively monitor the potential impact regulation may have both directly and indirectly on us. We maintain a process to actively monitor both actual and potential legal action that may affect us. Our risk management

framework is designed to identify, monitor and manage these risks under the oversight of the ERC.

We currently rely on the exemption from registration provided by Section 3(c)(5)(C) of the Investment Company Act, and we plan to continue to meet the requirements for this exemption from registration. The determination that we qualify for this exemption from registration depends on various factual matters and circumstances. Accordingly, in conjunction with our legal department, we closely monitor our compliance with Section 3(c)(5)(C) within our risk management program. The monitoring of this risk is also under the oversight of the ERC.

As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the U.S. Commodity Futures Trading Commission ("CFTC") gained jurisdiction over the regulation of interest rate swaps. The CFTC has asserted that this causes the operators of mortgage real estate investment trusts that use swaps as part of their business model to fall within the statutory definition of Commodity Pool Operator ("CPO"), and, absent relief from the Division of Swap Dealer and Intermediary Oversight or the CFTC, to register as CPOs. On December 7, 2012, as a result of numerous

requests for no-action relief from the CPO registration requirement for operators of mortgage real estate investment trusts, the Division of Swap Dealer and Intermediary Oversight of the CFTC issued no-action relief entitled "No-Action Relief from the Commodity Pool Operator Registration Requirement for Commodity Pool Operators of Certain Pooled Investment Vehicles Organized as Mortgage Real Estate Investment Trusts" that permits a CPO to receive relief by filing a claim to perfect the use of the relief. A claim submitted by a CPO will be effective upon filing, so long as the claim is materially complete. The conditions that must be met relate to initial margin and premiums requirements, net income derived annually from commodity interest positions that are not qualifying hedging transactions, marketing of interests in the mortgage real estate investment trust to the public, and identification of the entity as a mortgage real estate investment trust in its federal tax filings with the Internal Revenue Service. While we disagree with the CFTC's position that mortgage real estate investment trusts that use swaps as part of their business model fall within the statutory definition of a CPO, we have submitted a claim for the relief set forth in the no-action relief entitled "No-Action Relief from the Commodity Pool Operator Registration Requirement for Commodity Pool Operators of Certain Pooled Investment Vehicles Organized as Mortgage Real Estate Investment Trusts" and believe we meet the criteria for such relief set forth therein.

Critical Accounting Policies and Estimates

Our critical accounting policies that require us to make significant judgments or estimates are described below. For more information on these critical accounting policies and other significant accounting policies, see "Significant

Accounting Policies" in the Notes to the Consolidated Financial Statements.

Valuation of Financial Instruments

Residential Investment Securities

There is an active market for our Agency mortgage-backed securities, CRT securities and non-Agency mortgage-backed securities. Since we primarily invest in securities that can be valued using actively quoted prices for actively traded assets, there is a high degree of observable inputs and less subjectivity in measuring fair value. Internal fair values are determined using quoted prices from the TBA securities market, the Treasury curve and the underlying characteristics of the individual securities, which may include coupon, periodic and life caps, reset dates and the expected life of the security. Prepayment rates are difficult to predict and require estimation and judgment in the valuation of Agency mortgage-backed securities. All internal fair values are compared to external pricing sources and/or dealer quotes to determine reasonableness. Additionally, securities used as collateral for repurchase agreements are priced daily by counterparties to ensure sufficient collateralization, providing additional verification of our internal pricing.

Residential Mortgage Loans

There is an active market for the residential whole loans in which we invest. Since we primarily invest in residential loans that can be valued using actively quoted prices for similar assets, there are observable inputs in measuring fair value. Internal fair values are determined using quoted prices for similar market transactions, the Treasury curve and the underlying characteristics of the individual loans, which may include loan term, coupon, and reset dates. Prepayment rates are difficult to predict and are a significant estimate requiring judgment in the valuation of residential whole loans. All internal fair values are compared to external pricing sources to determine reasonableness.

Commercial Real Estate Investments

The fair value of commercial mortgage-backed securities classified as available-for-sale is determined based upon quoted prices of similar assets in recent market transactions and requires the application of judgment due to differences in the underlying collateral. These securities must also be evaluated for other-than-temporary impairment if the fair value of the security is lower than its amortized cost. Determining whether there is an other-than-temporary impairment may require us to exercise significant judgment and make estimates to determine expected cash flows incorporating assumptions such as changes in interest rates and loss expectations. For commercial real estate loans and preferred equity investments classified as held for investment, we apply significant judgment in evaluating the need for a loss reserve. Estimated net recoverable value of

the commercial real estate loans and preferred equity investments and other factors such as the fair value of any collateral, the amount and status of senior debt, the prospects of the borrower and the competitive landscape where the borrower conducts business must be considered in determining the allowance for loan losses. For commercial real estate loans held for sale, significant judgment may need to be applied in determining fair value of the loans and whether a valuation allowance is necessary. Factors that may need to be considered to determine fair value of a loan held for sale include the borrower's credit quality, liquidity and other market factors and the fair value of the underlying collateral.

Interest Rate Swaps

We use the overnight indexed swap (“OIS”) curve as an input to value substantially all of our uncleared interest rate swaps. We believe using the OIS curve, which reflects the interest rate typically paid on cash collateral, enables us to most accurately determine the fair value of uncleared interest rate swaps. Consistent with market practice, we exchange collateral (also called margin) based on the fair values of our interest rate swaps. Through this margining process, we may be able to compare our recorded fair value with the fair value calculated by the counterparty or derivatives clearing organization, providing additional verification of our recorded fair value of the uncleared interest rate swaps. We value our cleared interest rate swaps using the prices provided by the derivatives clearing organization.

Revenue Recognition

Interest income from coupon payments is accrued based on the outstanding principal amounts of the Residential Investment Securities and their contractual terms. Premiums and discounts associated with the purchase of the Residential Investment Securities are amortized or accreted into interest income over the projected lives of the securities using the interest method. We use third-party model and market information to project prepayment speeds. Our prepayment speed projections incorporate underlying loan characteristics (i.e., coupon, term, original loan size, original loan-to-value ratio, etc.) and market data, including interest rate and home price index forecasts and expert judgment. Prepayment speeds vary according to the type of investment, conditions in the financial markets and other factors and cannot be predicted with any certainty. Changes to model assumptions, including interest rates and other market data, as well as periodic revisions to the model will cause changes in the results. Adjustments are made for actual prepayment activity as it relates to calculating the effective yield. Gains or losses on sales of Residential Investment Securities are recorded on trade date based on the specific identification method.

Consolidation of Variable Interest Entities

Determining whether an entity has a controlling financial interest in a VIE requires significant judgment related to assessing the purpose and design of the VIE and determination of the activities that most significantly impact its economic performance. We must also identify explicit and implicit variable interests in the entity and consider our involvement in both the design of the VIE and its ongoing activities. To determine whether consolidation of the VIE is required, we must apply judgment to assess whether we have the power to direct the most significant activities of the VIE and whether we have either the rights to receive benefits or the obligation to absorb losses that could be potentially significant to the VIE.

Use of Estimates

The use of GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 2. Management's Discussion And Analysis

Glossary of Terms

A

Adjustable-Rate Loan / Security
A loan / security on which interest rates are adjusted at regular intervals according to predetermined criteria. The adjustable interest rate is tied to an objective, published interest rate index.

Agency
Refers to a federally chartered corporation, such as the Federal National Mortgage Association, or the Federal Home Loan Mortgage Corporation, or an agency of the U.S. Government, such as the Government National Mortgage Association.

Agency Mortgage-Backed Securities
Refers to residential mortgage-backed securities that are issued or guaranteed by an Agency.

Amortization
Liquidation of a debt through installment payments. Amortization also refers to the process of systematically reducing a recognized asset or liability (e.g., a purchase premium or discount for a debt security) with an offset to earnings.

Average Life
On a mortgage-backed security, the average time to receipt of each dollar of principal, weighted by the amount of each principal prepayment, based on prepayment assumptions.

B

Basis Point ("BP")
One hundredth of one percent, used in expressing differences in interest rates. One basis point is 0.01% of yield. For example, a bond's yield that changed from 3.00% to 3.50% would be said to have moved 50 basis points.

Benchmark
A bond or an index referencing a basket of bonds whose terms are used for comparison with other bonds of similar maturity. The global financial market typically looks to U.S. Treasury securities as benchmarks.

Beneficial Owner
One who benefits from owning a security, even if the security's title of ownership is in the name of a broker or bank.

B-Note
Subordinate mortgage notes and/or subordinate mortgage loan participations.

B-Piece

The most subordinate commercial mortgage-backed security bond class.

Board

Refers to the board of directors of Annaly.

Bond
The written evidence of debt, bearing a stated rate or stated rates of interest, or stating a formula for determining that rate, and maturing on a date certain, on which date and upon presentation a fixed sum of money plus interest (usually represented by interest coupons attached to the bond) is payable to the holder or owner. Bonds are long-term securities with an original maturity of greater than one year. For purposes of computations tied in to “per bond,” a $1,000 increment of an issue is used (no matter what the actual denominations are).

Book Value Per Share
Calculated by summing common stock, additional paid-in capital, accumulated other comprehensive income (loss) and accumulated deficit and dividing that number by the total common shares outstanding.

Broker
Generic name for a securities firm engaged in both buying and selling securities on behalf of customers or its own account.

C

Capital Buffer
Includes unencumbered financial assets which can be either sold or utilized as collateral to meet liquidity needs.

Capital Ratio
Calculated as total stockholders’ equity divided by total assets inclusive of outstanding market value of TBA positions and exclusive of consolidated VIEs.

Carry
The amount an asset earns over its hedging and financing costs. A positive carry happens when the rate on the securities being financed is greater than the rate on the funds borrowed. A negative carry is when the rate on the funds borrowed is greater than the rate on the securities that are being financed.
Collateral
Securities, cash or property pledged by a borrower or party to a derivative contract to secure payment of a loan or derivative. If the borrower fails to repay the loan or defaults under the derivative contract, the secured party may take ownership of the collateral.

Collateralized Mortgage Obligation ("CMO")
A multiclass bond backed by a pool of mortgage pass-through securities or mortgage loans.

Commodity Futures Trading Commission ("CFTC")
An independent U.S. federal agency established by the Commodity Futures Trading Commission Act of 1974. The CFTC regulates the swaps, commodity futures and options markets. Its goals include the promotion of competitive and efficient futures markets and the protection of investors against manipulation, abusive trade practices and fraud.

Commercial Mortgage-Backed Security ("CMBS")
Securities collateralized by a pool of mortgages on commercial real estate in which all principal and interest from the mortgages flow to certificate holders in a defined sequence or manner.

Constant Prepayment Rate ("CPR")
The percentage of outstanding mortgage loan principal that prepays in one year, based on the annualization of the Single Monthly Mortality, which reflects the outstanding mortgage loan principal that prepays in one month.

Convertible Securities
Securities which may be converted into shares of another security under stated terms, often into the issuing company's common stock.

Convexity
A measure of the change in a security's duration with respect to changes in interest rates. The more convex a security is, the more its duration will change with interest rate changes.

Core Earnings and Core Earnings Per Average Common Share
Non-GAAP measure that is defined as net income (loss) excluding gains or losses on disposals of investments and termination or maturity of interest rate swaps, unrealized gains or losses on interest rate swaps and instruments measured at fair value through earnings, net gains (losses) on other derivatives, impairment losses, net income (loss) attributable to noncontrolling interest, transaction expenses and certain other non-recurring gains or losses, and inclusive of TBA dollar roll income (a component of Net gains (losses) on other derivatives) and realized amortization of MSRs. Core earnings per average common share is calculated by dividing core earnings by average basic common shares for the period.

Corporate Debt
Non-government debt instruments issued by corporations. Long-term corporate debt can be issued as bonds or loans.

Counterparty
One of two entities in a transaction. For example, in the bond market a counterparty can be a state or local government, a broker-dealer or a corporation.

Coupon
The interest rate on a bond that is used to compute the amount of interest due on a periodic basis.

Credit and Counterparty Risk
Risk to earnings, capital or business, resulting from an obligor's or counterparty's failure to meet the terms of any contract or otherwise failure to perform as agreed. Credit and counterparty risk is present in lending, investing, funding and hedging activities.

Credit Derivatives
Derivative instruments that have one or more underlyings related to the credit risk of a specified entity (or group of entities) or an index that exposes the seller to potential loss from specified credit-risk related events. An example is credit derivatives referencing the commercial mortgage-backed securities index.

Credit Risk Transfer (“CRT”) Securities
Credit Risk Transfer securities are risk sharing transactions issued by Fannie Mae and Freddie Mac and similarly structured transactions arranged by third party market participants. The securities issued in the CRT sector are designed to synthetically transfer mortgage credit risk from Fannie Mae, Freddie Mac and/or third parties to private investors.

Current Face
The current remaining monthly principal on a mortgage security. Current face is computed by multiplying the original face value of the security by the current principal balance factor.

D

Dealer
Person or organization that underwrites, trades and sells securities, e.g., a principal market-maker in securities.

Default Risk
Possibility that a bond issuer will fail to pay principal or interest when due.

Derivative
A financial product that derives its value from the price, price fluctuations and price expectations of an underlying instrument, index or reference pool (e.g. futures contracts, options, interest rate swaps, interest rate swaptions and certain to-be-announced securities).

Discount Price
When the dollar price is below face value, it is said to be selling at a discount.

Duration
The weighted maturity of a fixed-income investment's cash flows, used in the estimation of the price sensitivity of fixed-income securities for a given change in interest rates.

E

Economic Capital
A measure of the risk a firm is subject to. It is the amount of capital a firm needs as a buffer to protect against risk. It is a probabilistic measure of potential future losses at a given confidence level over a given time horizon.

Economic Interest Expense
Non-GAAP financial measure that is composed of GAAP interest expense adjusted for realized gains or losses on interest rate swaps.

Economic Leverage Ratio (Economic Debt-to-Equity Ratio)
Calculated as the sum of recourse debt, TBA derivative notional outstanding and net forward purchases of investments divided by total equity.

Economic Net Interest Income
Non-GAAP financial measure that is composed of GAAP net interest income adjusted for realized gains or losses on interest rate swaps used to hedge cost of funds.

Encumbered Assets
Assets on the company's balance sheet which have been pledged as collateral against a liability.

Eurodollar
A U.S. dollar deposit held in Europe or elsewhere outside the United States.

F

Face Amount
The par value (i.e., principal or maturity value) of a security appearing on the face of the instrument.

Factor
A decimal value reflecting the proportion of the outstanding principal balance of a mortgage security, which changes over time, in relation to its original principal value.

Fannie Mae
Federal National Mortgage Association.

Federal Deposit Insurance Corporation ("FDIC")
An independent agency created by the U.S. Congress to maintain stability and public confidence in the nation's financial system by insuring deposits, examining and supervising financial institutions for safety and soundness and consumer protection, and managing receiverships.

Federal Funds Rate
The interest rate charged by banks on overnight loans of their excess reserve funds to other banks.

Federal Home Loan Banks (“FHLB”)
U.S. Government-sponsored banks that provide reliable liquidity to member financial institutions to support housing finance and community investment.

Federal Housing Financing Agency (“FHFA”)
The FHFA is an independent regulatory agency that oversees vital components of the secondary mortgage market including Fannie Mae, Freddie Mac and the Federal Home Loan Banks.

Financial Industry Regulatory Authority (“FINRA”)
FINRA is a non-governmental organization tasked with regulating all business dealings conducted between dealers, brokers and all public investors.

Fixed-Rate Mortgage
A mortgage featuring level monthly payments, determined at the outset, which remain constant over the life of the mortgage.

Fixed Income Clearing Corporation (“FICC”)
The FICC is an agency that deals with the confirmation, settlement and delivery of fixed-income assets in the U.S. The agency ensures the systematic and efficient settlement of U.S. Government securities and mortgage-backed security transactions in the market.

Floating Rate Bond
A bond for which the interest rate is adjusted periodically according to a predetermined formula, usually linked to an index.

Floating Rate CMO
A CMO tranche which pays an adjustable rate of interest tied to a representative interest rate index such as the LIBOR, the Constant Maturity Treasury or the Cost of Funds Index.

Freddie Mac
Federal Home Loan Mortgage Corporation.

Futures Contract
A legally binding agreement to buy or sell a commodity or financial instrument in a designated future month at a price agreed upon at the initiation of the contract by the buyer and seller. Futures contracts are standardized according to the quality, quantity, and delivery time and location for each commodity. A futures contract differs from an option in that an option gives one of the counterparties a right and the other an obligation to buy or sell, while a futures contract represents an obligation of both counterparties, one to deliver and the other to accept delivery. A futures contract is part of a class of financial instruments called derivatives.

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G

GAAP
U.S. generally accepted accounting principles.

Ginnie Mae
Government National Mortgage Association.

H

Hedge
An investment made with the intention of minimizing the impact of adverse movements in interest rates or securities prices.

I

In-the-Money
Description for an option that has intrinsic value and can be sold or exercised for a profit; a call option is in-the-money when the strike price (execution price) is below the market price of the underlying security.

Interest Bearing Liabilities
Refers to repurchase agreements, securitized debt of consolidated VIEs, FHLB Des Moines advances, credit facilities, U.S. Treasury securities sold, not yet purchased and securities loaned. Average Interest Bearing Liabilities is based on daily balances.

Interest Earning Assets
Refers to Residential Investment Securities, securities borrowed, U.S. Treasury securities, reverse repurchase agreements, commercial real estate debt investments, commercial real estate debt and preferred equity interests, residential mortgage loans and corporate debt. Average Interest Earning Assets is based on daily balances.

Interest-Only (IO) Bond
The interest portion of mortgage, Treasury or bond payments, which is separated and sold individually from the principal portion of those same payments.

Interest Rate Risk
The risk that an investment's value will change due to a change in the absolute level of interest rates, in the spread between two rates, in the shape of the yield curve or in any other interest rate relationship. As market interest rates rise, the value of current fixed income investment holdings declines. Diversifying, deleveraging and hedging techniques are utilized to mitigate this risk. Interest rate risk is a form of market risk.

Interest Rate Swap
A binding agreement between counterparties to exchange periodic interest payments on some predetermined dollar

principal, which is called the notional principal amount. For example, one party will pay fixed and receive a variable rate .

Interest Rate Swaption
Options on interest rate swaps. The buyer of a swaption has the right to enter into an interest rate swap agreement at some specified date in the future. The swaption agreement will specify whether the buyer of the swaption will be a fixed-rate receiver or a fixed-rate payer.

Internal Capital Adequacy Assessment Program ("ICAAP")
The ongoing assessment and measurement of risks, and the amount of capital which is necessary to hold against those risks. The objective is to ensure that a firm is appropriately capitalized relative to the risks in its business.

International Swaps and Derivatives Association ("ISDA") Master Agreement
Standardized contract developed by ISDA used as an umbrella under which bilateral derivatives contracts are entered into.

Inverse IO Bond
An interest-only bond whose coupon is determined by a formula expressing an inverse relationship to a benchmark rate, such as LIBOR. As the benchmark rate changes, the IO coupon adjusts in the opposite direction. When the benchmark rate is relatively low, the IO pays a relatively high coupon payment, and vice versa.

Investment/Market Risk
Risk to earnings, capital or business resulting in the decline in value of our assets caused from changes in market variables, such as interest rates, which affect the values of Residential Investment Securities and other investment instruments.

Investment Company Act
Refers to the Investment Company Act of 1940, as amended.

L

Leverage
The use of borrowed money to increase investing power and economic returns.

Leverage Ratio (Debt-to-Equity Ratio)
Calculated as total debt to total stockholders' equity. For purposes of calculating this ratio total debt includes repurchase agreements, other secured financing, securitized debt of consolidated VIEs and mortgages payable which are non-recourse to us, subject to customary carveouts.

LIBOR (London Interbank Offered Rate)
The rate banks charge each other for short-term Eurodollar loans. LIBOR is frequently used as the base for resetting rates

on floating-rate securities and the floating-rate legs of interest rate swaps.

Liquidity Risk
Risk to earnings, capital or business arising from our inability to meet our obligations when they come due without incurring unacceptable losses because of inability to liquidate assets or obtain adequate funding.

Long-Term CPR
The Company's projected prepayment speeds for certain Agency mortgage-backed securities using third-party model and market information. The Company's prepayment speed projections incorporate underlying loan characteristics (e.g., coupon, term, original loan size, original loan-to-value ratio, etc.) and market data, including interest rate and home price index forecasts. Changes to model assumptions, including interest rates and other market data, as well as periodic revisions to the model will cause changes in the results.

Long-Term Debt
Debt which matures in more than one year.

M

Market Agreed Coupon ("MAC") Interest Rate Swap
An interest rate swap contract structure with pre-defined, market agreed terms, developed by SIFMA and ISDA with the purpose of promoting liquidity and simplified administration.

Monetary Policy
Action taken by the Board of Governors of the Federal Reserve System to influence the money supply or interest rates.

Mortgage-Backed Security ("MBS")
A security representing a direct interest in a pool of mortgage loans. The pass-through issuer or servicer collects the payments on the loans in the pool and "passes through" the principal and interest to the security holders on a pro rata basis.

Mortgage Loan
A mortgage loan granted by a bank, thrift or other financial institution that is based solely on real estate as security and is not insured or guaranteed by a government agency.

Mortgage Servicing Rights ("MSRs")
Contractual agreements constituting the right to service an existing mortgage where the holder receives the benefits and bears the costs and risks of servicing the mortgage.

N

NAV
Net asset value.

Net Equity Yield

Calculated using GAAP net income, excluding depreciation and amortization expense, divided by average net equity.

Net Interest Income
Represents interest income earned on our portfolio investments, less interest expense paid for borrowings.

Net Interest Margin
Represents the sum of the Company's interest income plus TBA dollar roll income less interest expense and the net interest component of interest rate swaps divided by the sum of average Interest Earning Assets plus average TBA contract balances.

Net Interest Spread
Calculated by taking the average yield on Interest Earning Assets minus the average cost of Interest Bearing Liabilities, including the net interest payments on interest rate swaps used to hedge cost of funds.

Non-Performing Loan (“NPL”)
A loan that is close to defaulting or is in default.

Notional Amount
A stated principal amount in a derivative contract on which the contract is based.

O

Operational Risk
Risk to earnings, capital, reputation or business arising from inadequate or failed internal processes or systems, human factors or external events.

Option Contract
A contract in which the buyer has the right, but not the obligation, to buy or sell an asset at a set price on or before a given date. Buyers of call options bet that a security will be worth more than the price set by the option (the strike price), plus the price they pay for the option itself. Buyers of put options bet that the security’s price will drop below the price set by the option. An option is part of a class of financial instruments called derivatives, which means these financial instruments derive their value from the worth of an underlying investment.

Original Face
The face value or original principal amount of a security on its issue date.

Out-of-the-Money
Description for an option that has no intrinsic value and would be worthless if it expired today; for a call option, this situation occurs when the strike price is higher than the market price of the underlying security; for a put option, this situation

occurs when the strike price is less than the market price of the underlying security.

Over-The-Counter ("OTC") Market
A securities market that is conducted by dealers throughout the country through negotiation of price rather than through the use of an auction system as represented by a stock exchange.

P

Par
Price equal to the face amount of a security; 100%.

Par Amount
The principal amount of a bond or note due at maturity. Also known as par value.

Pass-Through Security
A securitization structure where a GSE or other entity "passes" the amount collected from the borrowers every month to the investor, after deducting fees and expenses.

Pool
A collection of mortgage loans assembled by an originator or master servicer as the basis for a security. In the case of Ginnie Mae, Fannie Mae, or Freddie Mac mortgage pass-through securities, pools are identified by a number assigned by the issuing agency.

Premium
The amount by which the price of a security exceeds its principal amount. When the dollar price of a bond is above its face value, it is said to be selling at a premium.

Premium Amortization Adjustment ("PAA")
The component of premium amortization representing the quarter-over-quarter change in estimated long-term CPR.

Prepayment
The unscheduled partial or complete payment of the principal amount outstanding on a mortgage loan or other debt before it is due.

Prepayment Risk
The risk that falling interest rates will lead to increased prepayments of mortgage or other loans, forcing the investor to reinvest at lower prevailing rates.

Prime Rate
The indicative interest rate on loans that banks quote to their best commercial customers.

Principal and Interest
The term used to refer to regularly scheduled payments or prepayments of principal and payments of interest on a mortgage or other security.

R

Rate Reset
The adjustment of the interest rate on a floating-rate security according to a prescribed formula.

Real Estate Investment Trust (“REIT”)
A special purpose investment vehicle that provides investors with the ability to participate directly in the ownership or financing of real-estate related assets by pooling their capital to purchase and manage mortgage loans and/or income property.

Recourse Debt
Debt on which the economic borrower is obligated to repay the entire balance regardless of the value of the pledged collateral. By contrast, the economic borrower’s obligation to repay non-recourse debt is limited to the value of the pledged collateral. Recourse debt consists of repurchase agreements, and other secured financing.

Reinvestment Risk
The risk that interest income or principal repayments will have to be reinvested at lower rates in a declining rate environment.

Re-Performing Loan (“RPL”)
A type of loan in which payments were previously delinquent by at least 90 days but have resumed.

Repurchase Agreement
The sale of securities to investors with the agreement to buy them back at a higher price after a specified time period; a form of short-term borrowing. For the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement.

Residential Investment Securities
Refers to Agency mortgage-backed securities, CRT securities and non-Agency mortgage-backed securities.

Residual
In a CMO, the residual is the tranche that collects any cash flow from the collateral that remains after obligations to the other tranches have been met.

Return on Average Equity
Calculated by taking earnings divided by average stockholders’ equity.

Reverse Repurchase Agreement
Refer to Repurchase Agreement. The buyer of securities effectively provides a collateralized loan to the seller.

Risk Appetite Statement
Defines the types and levels of risk we are willing to take in order to achieve our business objectives, and reflects our risk management philosophy.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 2. Management's Discussion And Analysis

S

Secondary Market
Ongoing market for bonds previously offered or sold in the primary market.

Settlement Date
The date securities must be delivered and paid for to complete a transaction.

Short-Term Debt
Generally, debt which matures in one year or less. However, certain securities that mature in up to three years may be considered short-term debt.

Spread
When buying or selling a bond through a brokerage firm, an individual investor will be charged a commission or spread, which is the difference between the market price and cost of purchase, and sometimes a service fee. Spreads differ based on several factors including liquidity.

T

Target Assets
Includes Agency mortgage-backed securities, to-be-announced forward contracts, CRT securities, MSRs, non-Agency mortgage-backed securities, residential mortgage loans, commercial real estate investments, and corporate debt.

To-Be-Announced Securities ("TBAs")
A contract for the purchase or sale of a mortgage-backed security to be delivered at a predetermined price, face amount, issuer, coupon and stated maturity on an agreed-upon future date but does not include a specified pool number and number of pools.

TBA Dollar Roll Income
TBA dollar roll income is defined as the difference in price between two TBA contracts with the same terms but different settlement dates. The TBA contract settling in the later month typically prices at a discount to the earlier month contract with the difference in price commonly referred to as the "drop". TBA dollar roll income represents the equivalent of interest income on the underlying security less an implied cost of financing.

Total Return
Investment performance measure over a stated time period which includes coupon interest, interest on interest, and any realized and unrealized gains or losses.

Total Return Swap
A derivative instrument where one party makes payments at a predetermined rate (either fixed or variable) while receiving a return on a specific asset (generally an equity index, loan or bond) held by the counterparty.

U

Unencumbered Assets
Assets on our balance sheet which have not been pledged as collateral against an existing liability.

U.S. Government-Sponsored Enterprise ("GSE") Obligations
Obligations of Agencies originally established or chartered by the U.S. government to serve public purposes as specified by the U.S. Congress, such as Fannie Mae and Freddie Mac; these obligations are not explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. government.

V

Value-at-Risk ("VaR")
A statistical technique which measures the potential loss in value of an asset or portfolio over a defined period for a given confidence interval.

Variable Interest Entity ("VIE")
An entity in which equity investors (i) do not have the characteristics of a controlling financial interest, and/or (ii) do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties.

Variation Margin
Cash or securities provided by a party to collateralize its obligations under a transaction as a result of a change in value of such transaction since the trade was executed or the last time collateral was provided.

Volatility
A statistical measure of the variance of price or yield over time. Volatility is low if the price does not change very much over a short period of time, and high if there is a greater change.

W

Warehouse Lending
A line of credit extended to a loan originator to fund mortgages extended by the loan originators to property purchasers. The loan typically lasts from the time the mortgage is originated to when the mortgage is sold into the secondary market, whether directly or through a securitization. Warehouse lending can provide liquidity to the loan origination market.

Weighted Average Coupon
The weighted average interest rate of the underlying mortgage loans or pools that serve as collateral for a security, weighted by the size of the principal loan balances.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 2. Management's Discussion And Analysis

Weighted Average Life ("WAL")
The assumed weighted average amount of time that will elapse from the date of a security's issuance until each dollar of principal is repaid to the investor. The WAL will change as the security ages and depending on the actual realized rate at which principal, scheduled and unscheduled, is paid on the loans underlying the MBS.

Y

Yield-to-Maturity
The expected rate of return of a bond if it is held to its maturity date; calculated by taking into account the current market price, stated redemption value, coupon payments and time to maturity and assuming all coupons are reinvested at the same rate; equivalent to the internal rate of return.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Quantitative and qualitative disclosures about market risk are contained within the section titled “Risk Management” of Item 2. “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

ITEM 4. CONTROLS AND PROCEDURES

Our management, including our Chief Executive Officer (the CEO) and Chief Financial Officer (the CFO), reviewed and evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act) as of the end of the period covered by this report. Based on that review and evaluation, the CEO and CFO have concluded that our current disclosure controls and procedures, as designed, (1) were effective in ensuring that information required to be disclosed by the Company in reports it files or submits under the Securities Exchange Act is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure and (2) were effective in ensuring that information required to be disclosed by the Company in reports it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC’s rules and forms.

There have been no changes in our internal controls over financial reporting that occurred during the three months ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are involved in various claims and legal actions arising in the ordinary course of business.

At June 30, 2018, we were not party to any pending material legal proceedings.

ITEM 1A. RISK FACTORS

Other than the following risk factors relating to the pending MTGE Acquisition, there have been no material changes to the risk factors disclosed in Item 1A. “Risk Factors” of our most recent annual report on Form 10-K. The materialization of any risks and uncertainties identified in our Special Note Regarding Forward-Looking Statements contained in this report together with those previously disclosed in our most recent annual report on Form 10-K or those that are presently unforeseen could result in significant adverse effects on our financial condition, results of operations and cash flows. See Item 2. “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Special Note Regarding Forward-Looking Statements” in this quarterly report or our most recent annual report on Form 10-K.

Risks Related to the MTGE Acquisition

Completion of the MTGE Acquisition remains subject to conditions that we cannot control.

The MTGE Acquisition is subject to various closing conditions, including the receipt of specified regulatory approvals. There are no assurances that all of the conditions necessary to consummate the MTGE Acquisition will be satisfied or that the conditions will be satisfied in the time frame expected.

Failure to consummate the MTGE Acquisition could negatively impact the share price of our common stock and our future business and financial results.

If the MTGE Acquisition is not consummated, our businesses may be adversely affected and, without realizing any of the potential benefits of having consummated the MTGE Acquisition, we will be subject to a number of risks, including the following:

- we will be required to pay certain costs and expenses relating to the MTGE Acquisition; and
- matters relating to the MTGE Acquisition (including integration planning) may require substantial commitments of time and resources by our management, which could otherwise have been devoted to other opportunities that may have been beneficial to us.

If the MTGE Acquisition is not consummated, these risks may materialize and may adversely affect our business, financial results and share price.

Risks Related to Annaly Following the MTGE Acquisition

We may fail to realize all of the expected benefits of the MTGE Acquisition or those benefits may take longer to realize than expected.

The full benefits of the MTGE Acquisition may not be realized as expected or may not be achieved within the anticipated time-frame, or at all. Failure to achieve the anticipated benefits of the MTGE Acquisition could adversely affect our results of operations or cash flows, cause dilution to our earnings per share or book value per share, decrease or delay the expected accretive effect of the MTGE Acquisition, and negatively impact the share price of our common stock.

In addition, we will be required to devote significant attention and resources prior to closing to prepare for the post-closing operation of Annaly, as the combined company. Post-closing, Annaly, as the combined company, will be required to devote significant attention and resources to successfully integrate the MTGE portfolio and operating businesses into the existing Annaly structure. In particular, prior to the acquisition, we will have limited experience operating MTGE's healthcare and senior living facilities portfolio. This business presents additional regulatory constraints and poses operational risks different from those that we have successfully managed in the past. This integration process, coupled with managing a new business line, may disrupt our businesses and, if ineffective, would limit the anticipated benefits of the MTGE Acquisition and could adversely affect our results of operations or cash flows, cause dilution to our earnings per share or book value per share, decrease or delay the expected accretive effect of the MTGE Acquisition, and negatively impact the share price of our common stock.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

We will incur direct and indirect costs as a result of the MTGE Acquisition.

We will incur substantial expenses in connection with and as a result completing the MTGE Acquisition and, following completion, we expect to incur additional expenses in connection with combining the businesses, operations, policies and procedures of the two companies. Factors beyond our control could affect the total amount or timing of these expenses, many of which, by their nature, are difficult to estimate accurately.

Risks Related to MTGE's Business

You should read and consider risk factors specific to MTGE's business that will also affect the combined company after the MTGE Acquisition. These risks are described in Part I, Item 1A of MTGE's Annual Report on Form 10-K for the fiscal year ended December 31, 2017, and in other documents filed with the SEC.

ITEM 5. OTHER INFORMATION

In October 2017, the Board formed a special committee of the Board comprised of four independent directors (the "Special Committee") to (i) consider, evaluate and, if deemed appropriate by the Committee in its sole discretion, negotiate, changes to the terms of the Management Agreement and (ii) recommend to the Board what action, if any, should be taken by the Board with respect to the Management Agreement. The Special Committee, with the assistance of its own independent legal, financial and compensation advisors, engaged in extensive discussions and negotiations with the Manager with respect to revisions to the Management Agreement and other agreements to address various matters that could adversely impact the Company, including retention risks related to key persons providing services to the Company and the Manager's right to provide services to persons other than the Company. On August 1, 2018, following the unanimous recommendation of the Special Committee, the Board, with the unanimous approval of its independent directors (the "Independent Directors"), approved the Amended and Restated Management Agreement and the Severance and Noncompetition Agreement summarized below. Mr. Keyes and Ms. Denahan recused themselves from the Board's discussion and vote on these matters.

In connection with these matters, the Special Committee hired and consulted with its own legal counsel, Hogan Lovells US LLP, financial advisor, HFF Securities, L.P., and compensation consultant, Frederic W. Cook & Co. Keefe, Bruyette & Woods, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated served as financial advisors to the Manager, and DLA Piper LLP (US) served as legal counsel to the Manager. Morgan, Lewis & Bockius LLP served as legal counsel to Mr. Keyes.

Amended and Restated Management Agreement

On August 1, 2018, the Company entered into an Amended and Restated Management Agreement (the "Amended Management Agreement") with the Manager. The Amended

Management Agreement amended and restated the prior Management Agreement.

The Amended Management Agreement expands the devotion of time and noncompetition provisions applicable to the Manager to provide that the Manager is required to devote its full business time and best efforts to the performance of the Manager's duties under the Amended Management Agreement, and is prohibited from managing, operating,

joining, controlling, participating in, or advising any person other than the Company without the prior written consent of the Risk Committee of the Board (the "Risk Committee"). The Amended Management Agreement also prohibits the Company from entering into any joint venture or making any co-investment without the approval of the Risk Committee.

The Amended Management Agreement's initial term ends on December 31, 2019 and will automatically renew for successive two-year terms unless at least two-thirds of the Independent Directors or the holders of a majority of the outstanding shares of the Company's common stock in their sole discretion elect to terminate the agreement for any or no reason upon 365 days prior written notice (such notice, a "Termination Notice"). During any period between the date of the Company's delivery of a Termination Notice (the "Notice Delivery Date") and the date designated by the Company as the date on which the Manager shall cease to provide management services to the Company (the "Termination Date"), the Manager shall continue to perform its duties and obligations under the Amended Management Agreement and cooperate with the Company to execute an orderly transition to a new manager.

If the Company makes an election to terminate the Amended Management Agreement, the Company may elect to accelerate the Termination Date to a date that is between seven and 90 days after the Notice Delivery Date. If the Company does not make an election to accelerate the Termination Date, then the Manager may elect to accelerate the Termination Date to the date that is 90 days after the

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Notice Delivery Date. If the Termination Date is accelerated (such date, the "Accelerated Termination Date") by either the Company or the Manager, to the extent practicable, during the 60-day period immediately following the Accelerated Termination Date, the Manager shall continue to cooperate with the Company and its new manager to execute an orderly transition.

In addition to any amounts accrued for the period prior to the Accelerated Termination Date, the Company shall pay the Manager an acceleration fee (the "Acceleration Fee") in an amount equal to the average annual management fee earned by the Manager during the 24-month period immediately preceding such Accelerated Termination Date multiplied by a fraction with a numerator of 365 minus the number of days from the Notice Delivery Date to the Accelerated Termination Date, and a denominator of 365. Any such Acceleration Fee shall be paid within 90 days following the Accelerated Termination Date.

The Amended Management Agreement provides that if, as a result of a termination of the agreement by the Company as described above, the Manager terminates an employee of the Manager without "cause" (as defined in the Amended Management Agreement) and such employee is not promptly re-hired by the Company or its new manager, the Manager shall provide severance payments to such employee in its discretion. The Amended Management Agreement also provides that the Manager shall endeavor to enter into employment or other services agreements with those employees of the Manager that enable it to provide management services to the Company.

The Amended Management Agreement may also be terminated by the Manager for any reason or no reason upon 365 days prior written notice, or with shorter notice periods by either the Company or the Manager for cause or by the Company in the event of a sale of the Manager that was not pre-approved by the Independent Directors.

Except as described herein, the terms and conditions of the Amended Management Agreement are substantially the same as described in our most recent Annual Report on Form 10-K. The foregoing description of the Amended Management Agreement does not purport to be complete and is qualified in its entirety by reference to the complete Amended Management Agreement, a copy of which is attached to this Quarterly Report on Form 10-Q as Exhibit 10.1 and incorporated by reference herein.

Severance and Noncompetition Agreement

On August 1, 2018, in conjunction with the execution of the Amended Management Agreement, the Company and Kevin Keyes, the Company's Chairman, Chief Executive Officer and President, also entered into a Severance and Noncompetition Agreement (the "Severance Agreement"). The term of the Severance Agreement continues through July

31, 2020, and will automatically renew for successive one-year terms unless either party gives written notice (a "Notice of Non-Renewal") to the other of its intention not to renew at least 180 days prior to the expiration of the then-current term.

Upon (i) the removal of Mr. Keyes as the Company's Chief Executive Officer without "cause" (as defined in the Severance Agreement), (ii) the resignation of Mr. Keyes with "good reason" (as defined in the Severance Agreement), or (iii) the expiration of the then-current term following a Notice of Non-Renewal provided by the Company (each, a "Severance Event"), the Company shall pay Mr. Keyes a cash payment equal to $30 million (the "Severance Payment"). The Severance Payment shall be payable in 12 equal monthly installments after Mr. Keyes's separation from service upon or following a Severance Event (the "Severance Period"); provided that if such separation from service occurs within two years immediately following a "change of control" (as defined in the Severance Agreement), the Severance Payment shall be made in a single lump sum. The payment of the Severance Payment shall be subject to the execution of a waiver and release of claims against the Company and its subsidiaries and affiliates and on the continued compliance with the noncompetition provisions described below.

The Severance Agreement prohibits Mr. Keyes, during both the term of the Severance Agreement and the Severance Period, from, directly or indirectly, owning, managing, operating, controlling, consulting with, being employed by or otherwise providing services to, or participating in the ownership, management, operation or control of, any person or entity who engages in or intends to engage in the conduct of a Competitive Business. For purposes of the Severance Agreement, “Competitive Business” means (i) investing in Agency residential mortgage-backed securities (“Agency RMBS”), (ii) investing primarily in non-Agency RMBS within securitized products and residential mortgage loan markets in the U.S., (iii) originating and investing in commercial mortgage loans, securities, and other commercial real estate debt and equity investments in the U.S., (iv) providing financing to private equity-backed middle market businesses in the U.S., or (v) any other line of business activities in which the Company is engaged at the time of Mr. Keyes’s removal or resignation or non-renewal (each of (ii), (iii), (iv) and (v), a “Non-Agency Business”), but only if, as of the end of the fiscal year of the Company immediately preceding the date of Mr. Keyes’s termination of service, the equity capital of the Company attributable to such Non-Agency Business constitutes more than 10% of the total shareholders’ equity of the Company

The foregoing description of the Severance Agreement does not purport to be complete and is qualified in its entirety by reference to the complete Severance Agreement, a copy of which is attached to this Quarterly Report on Form 10-Q as Exhibit 10.2 and incorporated by reference herein.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Articles Supplementary

On July 31, 2018, we filed with the State Department of Assessments and Taxation of the State of Maryland (the "SDAT"), Articles Supplementary (the "Articles Supplementary") to our charter, reclassifying and designating (i) 11,500,000 authorized but unissued shares of our preferred stock, $0.01 par value per share, without designation as to series or class, as shares of our undesignated common stock and (ii) 5,000,000 authorized but unissued shares of our 7.625% Series C Cumulative Redeemable Preferred Stock, $0.01 par value per share, as shares of our undesignated common stock. The Articles Supplementary became effective upon filing on July 31, 2018.

The foregoing description of the Articles Supplementary does not purport to be complete and is qualified in its entirety by reference to the complete Articles Supplementary, a copy of which is attached to this Quarterly Report on Form 10-Q as Exhibit 3.1 and incorporated by reference herein.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 6. Exhibits

ITEM 6. EXHIBITS

Exhibits:

The exhibits required by this item are set forth on the Exhibit Index attached hereto.

Exhibit Number	Exhibit Description
2.1	Agreement and Plan of Merger, by and among the Registrant, Mountain Merger Sub Corporation and MTGE Investment Corp., dated as of May 2, 2018 (incorporated by reference to Exhibit 2.1 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on May 3, 2018).
3.1	Articles Supplementary reclassifying and designating (i) 11,500,000 authorized but unissued shares of the Registrant's preferred stock, $0.01 par value per share, without designation as to series or class, as shares of Registrant's undesignated common stock and (ii) 5,000,000 authorized but unissued shares of Registrant's 7.625% Series C Cumulative Redeemable Preferred Stock, $0.01 par value per share, as shares of Registrant's undesignated common stock. †
3.15	Form of Articles Supplementary designating Annaly's 8.125% Series H Cumulative Redeemable Preferred Stock, liquidation preference $25.00 per share (incorporated by reference to Exhibit 3.15 to Annaly's Registration Statement (Registration No. 333-224968) on Form S-4A filed May 31, 2018).
4.10	Specimen Series H Preferred Stock Certificate (incorporated by reference to Exhibit 4.10 to Annaly's Registration Statement (Registration No. 333-224968) on Form S-4A filed May 31, 2018).
10.1	Amended and Restated Management Agreement, by and between the Registrant and Annaly Capital Management LLC, dated as of August 1, 2018. †
10.2	Severance and Noncompetition Agreement, by and between the Registrant and Kevin G. Keyes, dated as of August 1, 2018. *†
31.1	Certification of Kevin G. Keyes, Chief Executive Officer, President and Director (Principal Executive Officer) of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Glenn A. Votek, Chief Financial Officer (Principal Financial Officer) of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Kevin G. Keyes, Chief Executive Officer, President and Director (Principal Executive Officer) of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Glenn A. Votek, Chief Financial Officer (Principal Financial Officer) of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 101.INS XBRL	Instance Document †
Exhibit 101.SCH	Taxonomy Extension Schema Document †

XBRL Exhibit 101.CAL	Taxonomy Extension Calculation Linkbase Document †
XBRL Exhibit 101.DEF	Additional Taxonomy Extension Definition Linkbase Document Created†
XBRL Exhibit 101.LAB	Taxonomy Extension Label Linkbase Document †
XBRL Exhibit 101.PRE	Taxonomy Extension Presentation Linkbase Document †
XBRL	

* Management contracts or compensatory plans or arrangements.

† Submitted electronically herewith. Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Financial Condition at June 30, 2018 (Unaudited) and December 31, 2017 (Derived from the audited Consolidated Statement of Financial Condition at December 31, 2017); (ii) Consolidated Statements of Comprehensive Income (Loss) (Unaudited) for the three and six months ended June 30, 2018 and 2017; (iii) Consolidated Statements of Stockholders' Equity (Unaudited) for the six months ended June 30, 2018 and 2017; (iv) Consolidated Statements of Cash Flows (Unaudited) for the six months ended June 30, 2018 and 2017; and (v) Notes to Consolidated Financial Statements (Unaudited).

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Signatures

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the city of New York, State of New York.

ANNALY CAPITAL MANAGEMENT, INC.

Dated: August 2, 2018 By: /s/ Kevin G. Keyes
Kevin G. Keyes
Chief Executive Officer, President and Director
(Principal Executive Officer)

Dated: August 2, 2018 By: /s/ Glenn A. Votek
Glenn A. Votek
Chief Financial Officer (Principal Financial Officer)