ANNALY CAPITAL MANAGEMENT INC
Form 10-Q
May 08, 2015

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: MARCH 31, 2015

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, NEW YORK (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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the 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 April 30, 2015
Common Stock, $.01 par value	947,710,129

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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)

	March 31, 2015 (Unaudited)	December 31, 2014(1)
ASSETS		
Cash and cash equivalents (including cash pledged as collateral of $1,819,173 and $1,584,701, respectively)	$1,920,326	$1,741,244
Reverse repurchase agreements	100,000	100,000
Investments, at fair value:		
Agency mortgage-backed securities (including pledged assets of $63,865,632 and $74,006,480, respectively)	69,388,001	81,565,256
Agency debentures (including pledged assets of $691,716 and $1,368,350, respectively)	995,408	1,368,350
Agency CRT securities	108,337	-
Commercial real estate debt investments (including pledged assets of $104,000 and $0, respectively) (2)	1,515,903	-
Investment in affiliate	141,246	143,045
Commercial real estate debt and preferred equity, held for investment (including pledged assets of $72,750 and $0, respectively) (3)	1,498,406	1,518,165
Investments in commercial real estate	207,209	210,032
Corporate debt, held for investment	227,830	166,464
Receivable for investments sold	2,009,937	1,010,094
Accrued interest and dividends receivable	247,801	278,489
Receivable for investment advisory income (including from affiliate of $10,268 and $10,402, respectively)	10,268	10,402
Goodwill	94,781	94,781
Interest rate swaps, at fair value	25,908	75,225
Other derivatives, at fair value	113,503	5,499
Other assets	70,813	68,321
Total assets	$78,675,677	$88,355,367
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Repurchase agreements	60,477,378	71,361,926
Payable for investments purchased	5,205	264,984
Convertible Senior Notes	749,512	845,295

Securitized debt of consolidated VIEs (4)	1,491,829	260,700
Mortgages payable	146,470	146,553
Participation sold	13,589	13,693
Accrued interest payable	155,072	180,501
Dividends payable	284,310	284,293
Interest rate swaps, at fair value	2,025,170	1,608,286
Other derivatives, at fair value	61,778	8,027
Accounts payable and other liabilities	140,774	47,328
Total liabilities	65,551,087	75,021,586
Stockholders' Equity:		
7.875% Series A Cumulative Redeemable Preferred Stock: 7,412,500 authorized, issued and outstanding	177,088	177,088
7.625% Series C Cumulative Redeemable Preferred Stock: 12,650,000 authorized, 12,000,000 issued and outstanding	290,514	290,514
7.50% Series D Cumulative Redeemable Preferred Stock: 18,400,000 authorized, issued and outstanding	445,457	445,457
Common stock, par value $0.01 per share, 1,956,937,500 authorized, 947,698,431 and 947,643,079 issued and outstanding, respectively	9,477	9,476
Additional paid-in capital	14,787,117	14,786,509
Accumulated other comprehensive income (loss)	773,999	204,883
Accumulated deficit	(3,364,147)	(2,585,436)
Total stockholders' equity	13,119,505	13,328,491
Noncontrolling interest	5,085	5,290
Total equity	13,124,590	13,333,781
Total liabilities and equity	$78,675,677	$88,355,367

(1) Derived from the audited consolidated financial statements at December 31, 2014.

(2) Includes senior securitized commercial mortgage loans of a consolidated VIE carried at fair value of $1.4 billion and $0 at March 31, 2015 and December 31, 2014, respectively.

(3) Includes senior securitized commercial mortgage loans of a consolidated VIE with a carrying value of $361.2 million and $398.6 million carried at amortized cost, net of an allowance for losses of $0 and $0, at March 31, 2015 and December 31, 2014, respectively.

(4) Includes securitized debt of a consolidated VIE carried at fair value of $1.3 billion and $0 at March 31, 2015 and December 31, 2014, 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)

	For the Quarter Ended	
	March 31, 2015	March 31, 2014
Net interest income:		
Interest income	$519,172	$655,901
Interest expense	129,420	124,971
Net interest income	389,752	530,930
Other income (loss):		
Realized gains (losses) on interest rate swaps(1)	(158,239)	(260,435)
Realized gains (losses) on termination of interest rate swaps	(226,462)	(6,842)
Unrealized gains (losses) on interest rate swaps	(466,202)	(348,942)
Subtotal	(850,903)	(616,219)
Investment advisory income	10,464	6,123
Net gains (losses) on disposal of investments	62,356	79,710
Dividend income from affiliate	4,318	13,045
Net gains (losses) on trading assets	(6,906)	(146,228)
Net unrealized gains (losses) on interest-only Agency mortgage-backed securities	(33,546)	(20,793)
Other income (loss)	(1,082)	1,460
Subtotal	35,604	(66,683)
Total other income (loss)	(815,299)	(682,902)
General and administrative expenses:		
Compensation and management fee	38,629	38,521
Other general and administrative expenses	12,309	8,857
Total general and administrative expenses	50,938	47,378
Income (loss) before income taxes	(476,485)	(199,350)
Income taxes	14	4,001
Net income (loss)	(476,499)	(203,351)
Net income (loss) attributable to noncontrolling interest	(90)	-
Net income (loss) attributable to Annaly	(476,409)	(203,351)
Dividends on preferred stock	17,992	17,992
Net income (loss) available (related) to common stockholders	$(494,401)	$(221,343)

Net income (loss) per share available (related) to common stockholders:		
Basic	$(0.52)	$(0.23)
Diluted	$(0.52)	$(0.23)
Weighted average number of common shares outstanding:		
Basic	947,669,831	947,458,813
Diluted	947,669,831	947,458,813
Dividends Declared Per Share of Common Stock	$0.30	$0.30
Net income (loss)	$(476,499)	$(203,351)
Other comprehensive income (loss):		
Unrealized gains (losses) on available-for-sale securities	631,472	741,172
Reclassification adjustment for net (gains) losses included in net income (loss)	(62,356)	(80,718)
Other comprehensive income (loss)	569,116	660,454
Comprehensive income (loss)	92,617	457,103
Comprehensive income (loss) attributable to noncontrolling interest	(90)	-
Comprehensive income (loss) attributable to Annaly	$92,707	$457,103

(1) Consists of interest expense on interest rate swaps.

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
(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	Common stock par value	Additional paid-in capital	Accumulated other comprehensive income (loss)	Accumulated deficit	Total stockholders' equity	Noncontro intere
BALANCE, December 31, 2013	$177,088	$290,514	$445,457	$9,474	$14,765,761	$(2,748,933)	$(534,306)	$12,405,055	$-
Net income (loss) attributable to Annaly	-	-	-	-	-	-	(203,351)	(203,351)	-
Unrealized gains (losses) on available-for-sale securities	-	-	-	-	-	741,172	-	741,172	-
Reclassification adjustment for net (gains) losses included in net income (loss)	-	-	-	-	-	(80,718)	-	(80,718)	-
Net proceeds from direct purchase and dividend reinvestment	-	-	-	1	606	-	-	607	-
Contingent beneficial conversion feature on 4% Convertible Senior Notes	-	-	-	-	4,186	-	-	4,186	-
Preferred Series A dividends, declared $0.492 per share	-	-	-	-	-	-	(3,648)	(3,648)	-
Preferred Series C dividends, declared $0.477 per share	-	-	-	-	-	-	(5,719)	(5,719)	-

Preferred Series D dividends, declared $0.469 per share	-	-	-	-	-	-	(8,625)	(8,625)	-
Common dividends declared, $0.30 per share	-	-	-	-	-	-	(284,247)	(284,247)	-
BALANCE, March 31, 2014	$177,088	$290,514	$445,457	$9,475	$14,770,553	$(2,088,479)	$(1,039,896)	$12,564,712	$-
BALANCE, December 31, 2014	$177,088	$290,514	$445,457	$9,476	$14,786,509	$204,883	$(2,585,436)	$13,328,491	$5,29
Net income (loss) attributable to Annaly	-	-	-	-	-	-	(476,409)	(476,409)	-
Net income (loss) attributable to noncontrolling interest	-	-	-	-	-	-	-	-	(90
Unrealized gains (losses) on available-for-sale securities	-	-	-	-	-	631,472	-	631,472	-
Reclassification adjustment for net (gains losses included in net income (loss)	-	-	-	-	-	(62,356)	-	(62,356)	-
Stock compensation expense	-	-	-	-	39	-	-	39	-
Net proceeds from direct purchase and dividend reinvestment	-	-	-	1	569	-	-	570	-
Equity contributions from (distributions to) noncontrolling interest	-	-	-	-	-	-	-	-	(115
Preferred Series A dividends, declared $0.492 per share	-	-	-	-	-	-	(3,648)	(3,648)	-
Preferred Series C dividends, declared $0.477	-	-	-	-	-	-	(5,719)	(5,719)	-

per share									
Preferred Series D dividends, declared $0.469 per share	-	-	-	-	-	-	(8,625)	(8,625)	-
Common dividends declared, $0.30 per share	-	-	-	-	-	-	(284,310)	(284,310)	-
BALANCE, March 31, 2015	$177,088	$290,514	$445,457	$9,477	$14,787,117	$773,999	$(3,364,147)	$13,119,505	$5,08

See notes to consolidated financial statements.

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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)

	For the Quarter Ended March 31,	
	2015	2014
Cash flows from operating activities:		
Net income (loss)	$(476,499)	$(203,351)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Amortization of Investment Securities premiums and discounts, net	284,777	118,988
Amortization of commercial real estate investment premiums and discounts, net	(160)	792
Amortization of intangibles	1,195	99
Amortization of deferred financing costs	2,914	2,813
Amortization of net origination fees and costs, net	(1,190)	(973)
Amortization of contingent beneficial conversion feature and equity component of Convertible Senior Notes	11,758	6,410
Depreciation expense	2,823	292
Net gain on sale of commercial real estate	-	(1,213)
Net (gains) losses on sales of Investment Securities	(62,356)	(80,718)
Stock compensation expense	39	-
Unrealized (gains) losses on interest rate swaps	466,202	348,942
Net unrealized (gains) losses on interest-only Agency mortgage-backed securities	33,546	20,793
Net (gains) losses on trading assets	6,906	146,228
Proceeds from repurchase agreements of RCap	386,000,000	329,649,937
Payments on repurchase agreements of RCap	(391,250,000)	(324,602,992)
Proceeds from reverse repurchase agreements	15,325,000	35,181,890
Payments on reverse repurchase agreements	(15,325,000)	(35,526,265)
Proceeds from securities borrowed	-	19,993,580
Payments on securities borrowed	-	(17,924,187)
Proceeds from securities loaned	-	37,178,735
Payments on securities loaned	-	(39,192,893)
Proceeds from U.S. Treasury securities	-	3,159,253
Payments on U.S. Treasury securities	-	(3,920,425)
Net payments on derivatives	(66,604)	(90,440)
Net change in:		
Due to / from brokers	-	8,596
Other assets	(2,627)	3,439
Accrued interest and dividends receivable	28,886	(16,035)
Receivable for investment advisory income	134	341
Accrued interest payable	(25,425)	25,032
Accounts payable and other liabilities	3,709	13,801
Net cash provided by (used in) operating activities	(5,041,972)	4,300,469

Cash flows from investing activities:		
Payments on purchases of Investment Securities	(5,065,764)	(9,367,034)
Proceeds from sales of Investment Securities	13,973,224	6,155,091
Principal payments on Agency mortgage-backed securities	2,596,964	1,675,575
Payments on purchases of corporate debt	(63,015)	(28,705)
Principal payments on corporate debt	1,733	1,051
Purchases of commercial real estate debt investments	(185,925)	-
Sales of commercial real estate debt investments	41,016	-
Purchase of securitized loans at fair value	(1,370,011)	-
Origination of commercial real estate investments, net	(61,502)	(125,949)
Proceeds from sales of commercial real estate held for sale	-	20,740
Principal payments on commercial real estate investments	82,408	69,795
Purchase of equity securities	(3,602)	-
Net cash provided by (used in) investing activities	9,945,526	(1,599,436)

Statements continued on following page.

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

Cash flows from financing activities:		
Proceeds from repurchase agreements	57,776,249	49,726,537
Principal payments on repurchase agreements	(63,410,797)	(52,010,534)
Payments on maturity of convertible senior notes	(107,541)	-
Proceeds from other secured financing	90,000	-
Proceeds from issuance of securitized debt	1,267,914	260,700
Principal repayments on securitized debt	(37,680)	-
Payment of deferred financing cost	(641)	(4,288)
Net proceeds from direct purchases and dividend reinvestments	569	607
Principal payments on participation sold	(76)	(72)
Principal payments on mortgages payable	(69)	-
Distributions to noncontrolling interests	(115)	-
Dividends paid	(302,285)	(302,222)
Net cash provided by (used in) financing activities	(4,724,472)	(2,329,272)
Net (decrease) increase in cash and cash equivalents	179,082	371,761
Cash and cash equivalents, beginning of period	1,741,244	552,436
Cash and cash equivalents, end of period	$1,920,326	$924,197
Supplemental disclosure of cash flow information:		
Interest received	$815,765	$769,627
Dividends received	$4,048	$13,045
Investment advisory income received	$10,992	$6,464
Interest paid (excluding interest paid on interest rate swaps)	$124,673	$118,131
Net interest paid on interest rate swaps	$176,395	$250,571
Taxes paid	$643	$2,137
Noncash investing activities:		
Receivable for investments sold	$2,009,937	$19,116
Payable for investments purchased	$5,205	$1,898,507
Net change in unrealized gains (losses) on available-for-sale securities, net of reclassification adjustment	$569,116	$660,454
Noncash financing activities:		
Dividends declared, not yet paid	$284,310	$284,247
Contingent beneficial conversion feature on 4% Convertible Senior Notes	$-	$4,186

See notes to consolidated financial statements.

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

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 owns a portfolio of real estate related investments, including mortgage pass-through certificates, collateralized mortgage obligations, Agency debentures, other securities representing interests in or obligations backed by pools of mortgage loans, commercial real estate assets and corporate loans. The Company’s principal business objective is to generate net income for distribution to its stockholders from its investments. The Company is externally managed by Annaly Management Company LLC (the “Manager”).

The Company’s business operations are primarily comprised of the following:

– Annaly, the parent company, which invests primarily in various types of Agency mortgage-backed securities and related derivatives to hedge these investments.

– Annaly Commercial Real Estate Group, Inc. (“ACREG,” formerly known as CreXus Investment Corp. (“CreXus”)), a wholly-owned subsidiary that was acquired during the second quarter of 2013 which specializes in acquiring, financing and managing commercial real estate loans and other commercial real estate debt, commercial mortgage-backed securities and other commercial real estate-related assets.

– RCap Securities, Inc. (“RCap”), a wholly-owned subsidiary which operates as a broker-dealer, and is a member of the Financial Industry Regulatory Authority (“FINRA”).

– Fixed Income Discount Advisory Company (“FIDAC”), a wholly-owned subsidiary which manages an affiliated real estate investment trust (“REIT”) for which it earns fee income.

The Company has elected to be taxed as a REIT as defined under the Internal Revenue Code of 1986, as amended, and regulations promulgated thereunder (the “Code”).

2. BASIS OF PRESENTATION

The accompanying consolidated financial statements and related notes of the Company have been prepared in accordance with accounting principles generally accepted in the United States ("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, 2014 has been derived from audited consolidated financial statements not included herein.

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.

3. SIGNIFICANT ACCOUNTING POLICIES

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

The Company has evaluated all of its investments in legal entities in order to determine if they are variable interests in Variable Interest Entities ("VIEs"). 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

– Annaly Middle Market Lending LLC (“MML”) (formerly known as Charlesfort Capital Management LLC), a wholly-owned subsidiary which engages in corporate middle market lending transactions.

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. 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

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that most significantly impact the VIE's economic performance and (ii) has the obligation to absorb losses of the VIE that could potentially be significant to the VIE 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 parties that make the most significant decisions affecting the VIE or have the right to unilaterally remove those decision makers are deemed to have the power to direct the activities of a 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 applies 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; relative share of interests held across various classes within the VIE's capital structure; and the reasons why the interests are held by the Company.

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 regarding the VIE to change.

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 to its interest rate swaps and other derivatives totaled approximately $1.8 billion and $1.6 billion at March 31, 2015 and December 31, 2014, 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, Agency Debentures and Agency Credit Risk Transfer Securities – The Company invests primarily in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of 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 Agency debentures issued by the Federal Home Loan Banks, Freddie Mac and Fannie Mae and securities in the Agency credit risk transfer ("CRT") sector. The CRT sector is comprised of the 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 and Freddie Mac to private investors.

Agency mortgage-backed securities, Agency debentures and Agency CRT securities are referred to herein as "Investment Securities." Although the Company generally intends to hold most of its Investment Securities until counterparties. Cash and securities deposited with clearing organizations are 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. RCap 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

maturity, it may, from time to time, sell any of its Investment Securities as part of its overall management of its portfolio. Investment Securities are classified as available-for-sale and are reported at fair values estimated by management that are compared to independent sources for reasonableness, with unrealized gains and losses reported as a component of other comprehensive income (loss). Investment Securities transactions are recorded on trade date, including TBA securities that meet the regular-way securities scope exception from derivative accounting. Realized gains and

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

losses on sales of Investment Securities are determined using the average cost method.

The Company elected the fair value option for Agency interest-only mortgage-backed securities. Interest-only securities and inverse interest-only securities are collectively referred to as "interest-only securities." These Agency interest-only mortgage-backed securities represent the Company's right to receive a specified proportion of the contractual interest flows of specific Agency mortgage-backed securities. Agency interest-only mortgage-backed securities are measured at fair value with changes in fair value recorded as Net unrealized gains (losses) on interest-only Agency mortgage-backed securities 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.

Interest income from coupon payments is accrued based on the outstanding principal amounts of the Investment Securities and their contractual terms. Premiums and discounts associated with the purchase of the Investment Securities are amortized or accreted into interest income over the projected lives of the securities using the interest method. The Company uses a third-party supplied model to project prepayment speeds related to Investment Securities. The Company's prepayment speed projections incorporate underlying loan characteristics (e.g., coupon, term, original loan size, original loan to value, 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. Adjustments are made for actual prepayment activity.

Corporate Debt – The Company's investments in corporate debt are designated as held for investment, and are carried at their principal balance outstanding plus any premiums or discounts less allowances for loan losses. No allowance for loan losses was deemed necessary as of March 31, 2015 and December 31, 2014.

unrealized gains and losses reported as a component of other comprehensive income (loss). Equity securities classified as trading are reported at fair value, based on market quotes, with unrealized gains and losses reported in the Consolidated Statements of Comprehensive Income (Loss) as Net gains (losses) on trading assets. Dividends are recorded in earnings based on the declaration date.

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 with the intent to net settle ("TBA derivatives"), options on TBA securities ("MBS options") and U.S. Treasury and Eurodollar futures contracts. The Company may also invest in other types of mortgage derivatives such as interest-only securities and synthetic total return swaps, such as the Markit IOS Synthetic Total Return Swap Index. 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). 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 swaps are the primary instrument used to mitigate interest rate risk. In particular, the Company uses interest rate swaps to manage its exposure to changing interest rates on its repurchase agreements by economically hedging cash flows associated with these borrowings. Swap agreements may or may not be cleared through a

Equity Securities – The Company may invest in equity securities that are classified as available-for-sale or trading. Equity securities classified as available-for-sale are reported at fair value, based on market quotes, with

derivatives clearing organization ("DCO"). Uncleared swaps are fair valued using internal pricing models and compared to the counterparty market values. Centrally cleared swaps are fair valued using internal pricing models and compared to the DCO's market values.

Interest rate swaptions - Interest rate swaptions are purchased/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/received for interest rate swaptions is reported as an asset/liability in the Consolidated Statement of Financial Condition. The difference between the premium and the fair value of the swaption is reported in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss). If a swaption expires unexercised, the realized gain (loss) on the swaption would be equal to the premium received/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 interest rate 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 similar methods used to value Agency mortgage-backed securities with gains and losses recorded in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

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 fair valued using internal pricing models and compared to the counterparty market value at the valuation date with gains and losses recorded in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

Futures Contracts - Futures contracts are derivatives that track the prices of specific assets. Short sales of futures contracts help mitigate the potential impact of changes in interest rates on the portfolio performance. The 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). There was no other-than-temporary impairment recognized for the quarters ended March 31, 2015 and 2014.

Loan Loss Reserves – 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 to verify they meet the covenants of the loan documents. If based on the financial review it is deemed probable that the Company will be unable to collect contractual principal and interest amounts (e.g. financial performance and delinquencies), a loan loss provision would be recorded. No allowance for loan losses was deemed necessary as of March 31, 2015 and December 31, 2014.

Repurchase Agreements – The Company finances the acquisition of a significant portion of its Agency mortgage-backed securities with repurchase agreements. The Company examines each of the specified criteria in ASC 860, Transfers and Servicing, at the inception of each transaction and has determined that each of the financings meet the specified criteria in this guidance.

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 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 with gains and losses recorded in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

Other-Than-Temporary Impairment – Management evaluates available-for-sale securities for other-than-

Company reports cash flows on repurchase agreements as financing activities in the Consolidated Statements of Cash Flows. The Company reports cash flows on reverse repurchase and repurchase agreements entered into by RCap as operating activities in the Consolidated Statements of Cash Flows.

Goodwill and Intangible Assets – The Company's acquisitions of FIDAC and CreXus were accounted for using the acquisition method. 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 of FIDAC and CreXus were 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 was recognized as goodwill.

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.

Intangible assets with an estimated useful life are amortized over their expected useful lives.

Convertible Senior Notes – The Company records the 4% Convertible Senior Notes and 5% Convertible Senior Notes (collectively, the "Convertible Senior Notes") at their contractual amounts, adjusted by the effects of a beneficial conversion feature and a contingent beneficial conversion feature (collectively, the "Conversion Features"). The Conversion Features' intrinsic value is included in "Additional paid-in capital" on the Company's Consolidated Statements of Financial Condition and reduces the recorded liability amount associated with the Convertible Senior Notes. A Conversion Feature may be recognized as a result of adjustments to the conversion price for dividends declared to common stockholders.

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 subsidiaries, including FIDAC, RCap and certain subsidiaries of ACREG, 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 necessary as of March 31, 2015 and December 31, 2014.

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 from those estimates.

Commercial Real Estate Investments

Commercial Real Estate Loans – The Company's commercial real estate loans are comprised of fixed-rate and adjustable-rate loans. Commercial real estate loans are designated as held for investment and are originated or purchased by the Company and carried at their outstanding principal balance, net of unamortized origination fees and costs, premiums or discounts, less a reserve for estimated losses if necessary. The difference between the principal amount of a loan and proceeds at acquisition is recorded as either a discount or premium. Origination fees and costs, premiums and discounts are amortized or accreted into interest income over the estimated life of the loan. The Company has also 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 be subject to 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

elected the fair value option for multi-family mortgage loans held in a securitization trust that it was required to consolidate. Interest income is recognized as earned determined by the stated coupon and outstanding principal balance. See "Commercial Real Estate Investments" footnote for additional information.

Preferred Equity Interests Held for Investment – 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. Origination fees and costs, premiums and discounts are amortized or accreted into interest income over the estimated life of the investment.

Allowance for Losses – The Company evaluates the need for a loss reserve on its commercial real estate loans and preferred equity interests held for investment (collectively referred to as "CRE Debt and Preferred Equity Investments"). A provision for losses related to CRE Debt and Preferred Equity Investments, 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 collectable. 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. Because this determination is 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 the nature of the assets underlying the 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. Management reviews loan-to-value metrics upon either the origination or the acquisition of a new investment but generally does not update the

In connection with the quarterly surveillance review process, loans are assigned an internal rating of "Performing", "Watch List", "Defaulted-Recovery" or "Impaired". Loans that are deemed to be Performing meet all present contractual obligations and do not qualify for Watch List designation. Watch List loans are defined as Performing loans that are significantly lagging expectations and/or for which there is an increased potential for default. Defaulted–Recovery loans are currently in default; however full recovery of contractual principal and interest is expected. Impaired loans may or may not be in default, impairment is anticipated, and a loan loss provision has been recognized to reflect expected losses.

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	31-40 years
Site improvements	1-10 years

The Company follows the acquisition method of accounting for acquisitions of operating real estate held for investment, where the purchase price of operating real estate is allocated to tangible assets such as land, building, site improvements and other identified intangibles such as above/below market and in-place leases.

The Company evaluates whether real estate acquired in connection with a foreclosure ("REO") or UCC/deed in loan-to-value metrics in the course of quarterly surveillance. 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. Management also reviews economic trends, both macro as well as those directly affecting the property, and the supply and demand of competing projects in the sub-market in which each subject property is located.

lieu of foreclosure (herein collectively referred to as a foreclosure) 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, which 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. In addition, if considered material to the overall consolidated financial statements, the results of operations are reclassified to income (loss) from discontinued operations in the Consolidated Statements of Comprehensive Income (Loss).

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 the CRE Debt and Preferred Equity Investments and their contractual terms. Premiums and discounts associated with the purchase of CRE Debt and Preferred Equity Investments are amortized or accreted into interest income over the projected lives of the CRE Debt and Preferred Equity Investments using the interest method.

are collateralized by mortgage-backed or other securities. Margin calls are made by RCap as necessary based on the daily valuation of the underlying collateral as compared to the contract price. RCap generates income from the spread between what is earned on the reverse repurchase agreements and what is paid on the matched repurchase agreements. RCap’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 RCap will require counterparties to deposit additional collateral, when necessary. All reverse repurchase activities are transacted under master repurchase agreements that give RCap the right, in the event of default, to liquidate collateral held and in some instances, to offset receivables and payables with the same counterparty.

Securities Borrowed and Loaned Transactions – RCap recorded securities borrowed and loaned transactions as collateralized financings. Securities borrowed transactions required RCap to provide the counterparty with collateral in the form of cash, or other securities. RCap received collateral in the form of cash or other securities for securities loaned transactions. RCap monitored the fair value of the securities borrowed and loaned on a daily basis, with additional collateral obtained or refunded as necessary. Securities borrowed and securities loaned transactions were recorded at contract value. For these transactions, the rebates accrued by RCap were recorded as interest income or expense.

U.S. Treasury Securities – RCap traded in U.S. Treasury securities for its proprietary portfolio, which consisted of long and short positions on U.S Treasury notes and bonds. U.S. Treasury securities were classified as trading investments and were recorded on the trade date at cost. Changes in fair value were reflected in Net gains (losses) on trading assets in the Company’s Consolidated Statement of Comprehensive Income (Loss). Interest income or expense on U.S. Treasury notes and bonds was accrued based on the outstanding principal amount of those investments and their stated terms.

Broker Dealer Activities

In January 2014, RCap ceased its trading activity in U.S. Treasury securities, derivatives and securities borrowed and loaned transactions.

Reverse Repurchase Agreements – RCap enters into reverse repurchase agreements as part of its matched book trading activity. Reverse repurchase agreements are recorded on settlement date at the contract amount and

Derivatives - RCap entered primarily into U.S. Treasury, Eurodollar, federal funds, German government and U.S. equity index and currency futures and options contracts. RCap maintained a margin account which was settled daily with FCMs. Changes in the unrealized gains or losses on the futures and options contracts as well as any foreign exchange gains and losses were reflected in Net gains (losses) on trading assets in the Company's Consolidated Statements of Comprehensive Income (Loss). Unrealized gains (losses) were excluded from net income (loss) in arriving at cash flows from operating activities in the Consolidated Statements of Cash Flows.

Recent Accounting Pronouncements

The following table provides a brief description of recent accounting pronouncements that could potentially impact the Company's consolidated financial statements:

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Standard	Description	Date of Adoption	Effect on the financial statements or other significant matters
Standards that are not yet adopted			
ASU 2015-05 - Customer's Accounting for Fees Paid in a Cloud Computing Arrangement	This update clarifies that customers should determine whether a cloud computing arrangement includes the license of software by applying the same guidance cloud service providers use. The guidance also eliminates the current requirement that customers analogized to the leasing standard when determining the asset acquired in a software licensing arrangement.		Not expected to have a significant impact on the consolidated financial statements
ASU 2015-03 Interest - Imputation of Interest (Subtopic 835-30) Simplifying the Presentation of Debt Issuance Costs	This ASU requires that debt issue costs are presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The recognition and measurement of debt issue costs are not affected.	January 1, 2016 (early adoption permitted)	Impacts presentation only and will not have a significant impact on the consolidated financial statements.
ASU 2015-02 Consolidation (Topic 810) Amendments to the Consolidation Analysis	This update affects the following areas of the consolidation analysis: limited partnerships and similar entities, evaluation of fees paid to a decision maker or service provider as a variable interest and in determination of the primary beneficiary, effect of related parties on the primary beneficiary determination and for certain investment funds.		Not expected to have a significant impact on the consolidated financial statements
ASU 2015-01 Income Statement - Extraordinary and Unusual Items (Subtopic 225-20)	This update eliminates from GAAP the concept of extraordinary items.	January 1, 2016 (early adoption permitted)	Not expected to have an impact on the consolidated financial statements.
ASU 2014-16 Derivatives and Hedging (Topic 815)	This ASU provides additional guidance for evaluating	January 1, 2016 (early adoption	Not expected to have an impact on the consolidated

Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share is More Akin to Debt or Equity	whether conversion rights, redemption rights, voting rights, liquidation rights and dividend payment preferences and other features embedded in a share, including preferred stock, contain embedded derivatives requiring bifurcation. The update requires that an entity determine the nature of the host contract by considering all stated and implied terms and features in a hybrid instrument.	permitted)	financial statements.
ASU 2014-15, Presentation of Financial Statements – Going Concern (Subtopic 205-04) Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern	This ASU requires management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date the financial statements are issued.	January 1, 2017 (early adoption permitted)	Not expected to have an impact on the consolidated financial statements.
ASU 2014-09, Revenue from Contracts with Customers	This guidance applies to contracts with customers to transfer goods or services and contracts to transfer nonfinancial assets unless those contracts are within the scope of other standards (for example, lease transactions).	January 1, 2017	Not expected to have a significant impact on the consolidated financial statements.
Standards that were adopted			
ASU 2014-17 Business Combinations (Topic 805): Pushdown Accounting	This amendment provides an acquired entity with the option to apply push down accounting in its separate financial statements upon occurrence of an event in which an acquirer obtains control of the acquired entity.	November 18, 2014	Did not have a significant impact on the consolidated financial statements.
ASU 2014-13, Consolidation (Topic 810) Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized	This Update provides a practical expedient to measure the fair value of the financial assets and financial liabilities of a consolidated	January 1, 2015 (early adoption permitted)	The Company early adopted this ASU and applied the guidance to a commercial mortgage backed securitization transaction. See

Financing Entity.	collateralized financing entity, which the reporting entity has elected to or is required to measure on a fair value basis.		"Commercial Real Estate Investments" footnote for further disclosure.
ASU 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosure.	This update makes limited amendments to the guidance in ASC 860 on accounting for certain repurchase agreements.	January 1, 2015, except for the disclosure requirements for transactions accounted for as secured borrowings, which are required to be presented for interim periods beginning after March 15, 2015	Impacts disclosures only and does not have a significant impact on the consolidated financial statements.
ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360) Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity	This ASU raises the threshold for a disposal to be treated as discontinued operations.	January 1, 2015 (early adoption permitted)	Did not have a significant impact on the consolidated financial statements.
ASU 2014-04 Receivables–Troubled Debt Restructurings by Creditors, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure	This update clarifies that an in substance repossession or foreclosure has occurred, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, when the creditor obtains legal title to the property upon completion of a foreclosure or the borrower conveys all interest in the property to the creditor through a deed in lieu of foreclosure or similar arrangement	January 1, 2015	Did not have a significant impact on the consolidated financial statements.
ASU 2013-02, Comprehensive Income: Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income	This update requires the provision of information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, it requires presentation of significant amounts reclassified out of accumulated other comprehensive income by the	January 1, 2014	Did not have a significant impact on the consolidated financial statements.

	respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period		
ASU 2011-11, Balance Sheet: Disclosures about Offsetting Assets and Liabilities	Under this update, the Company is required to disclose both gross and net information about both instruments and transactions eligible for offset in the Company's Consolidated Statements of Financial Condition and transactions subject to an agreement similar to a master netting arrangement. The scope includes derivatives, sale and repurchase agreements and reverse sale and repurchase agreements and securities borrowing and securities lending arrangements.	January 1, 2014	Did not have a significant impact on the consolidated financial statements.

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4. AGENCY MORTGAGE-BACKED SECURITIES

The following tables present the Company's available-for-sale Agency mortgage-backed securities portfolio as of March 31, 2015 and December 31, 2014, which were carried at their fair value:

March 31, 2015	Freddie Mac	Fannie Mae	Ginnie Mae	Total
	(dollars in thousands)			
Principal outstanding	$ 23,214,759	$ 40,662,639	$ 92,317	$ 63,969,715
Unamortized premium	1,814,818	2,857,467	19,773	4,692,058
Unamortized discount	(7,489)	(7,549)	(347)	(15,385)
Amortized cost	25,022,088	43,512,557	111,743	68,646,388
Gross unrealized gains	345,566	759,828	8,374	1,113,768
Gross unrealized losses	(160,483)	(208,764)	(2,908)	(372,155)
Estimated fair value	$ 25,207,171	$ 44,063,621	$ 117,209	$ 69,388,001

	Fixed Rate	Adjustable Rate	Total
	(dollars in thousands)		
Amortized cost	$ 65,176,426	$ 3,469,962	68,646,388
Gross unrealized gains	971,043	142,725	1,113,768
Gross unrealized losses	(355,330)	(16,825)	(372,155)
Estimated fair value	$ 65,792,139	$ 3,595,862	$ 69,388,001

December 31, 2014	Freddie Mac	Fannie Mae	Ginnie Mae	Total
	(dollars in thousands)			
Principal outstanding	$ 27,906,221	$ 47,979,778	$ 97,000	$ 75,982,999
Unamortized premium	1,951,798	3,396,368	20,560	5,368,726
Unamortized discount	(8,985)	(8,857)	(358)	(18,200)
Amortized cost	29,849,034	51,367,289	117,202	81,333,525
Gross unrealized gains	313,761	660,230	8,010	982,001
Gross unrealized losses	(322,094)	(424,800)	(3,376)	(750,270)
Estimated fair value	$ 29,840,701	$ 51,602,719	$ 121,836	$ 81,565,256

	Fixed Rate	Adjustable Rate	Total
	(dollars in thousands)		
Amortized cost	$ 78,250,313	$ 3,083,212	$ 81,333,525
Gross unrealized gains	847,615	134,386	982,001
Gross unrealized losses	(732,533)	(17,737)	(750,270)
Estimated fair value	$ 78,365,395	$ 3,199,861	$ 81,565,256

Actual maturities of Agency mortgage-backed securities are generally shorter than stated contractual maturities because actual maturities of Agency mortgage-backed securities are affected by periodic payments and prepayments of principal on the underlying mortgages.

The following table summarizes the Company's Agency mortgage-backed securities as of March 31, 2015 and December 31, 2014, according to their estimated weighted average life classifications:

	March 31, 2015		December 31, 2014	
Weighted Average Life	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost
	(dollars in thousands)			
Less than one year	$27,752	$27,847	$43,248	$42,831
Greater than one year through five years	46,648,676	46,120,064	42,222,114	41,908,586
Greater than five years through ten years	22,520,713	22,308,291	39,018,833	39,098,352
Greater than ten years	190,860	190,186	281,061	283,756
Total	$69,388,001	$68,646,388	$81,565,256	$81,333,525

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The weighted average lives of the Agency mortgage-backed securities at March 31, 2015 and December 31, 2014 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 by length of time that such securities have been in a continuous unrealized loss position at March 31, 2015 and December 31, 2014.

	March 31, 2015			December 31, 2014		
	Estimated Fair Value	Gross Unrealized Losses	Number of Securities	Estimated Fair Value	Gross Unrealized Losses	Number of Securities
	(dollars in thousands)					
Less than 12 Months	2,595,905	(54,883)	207	4,613,599	(36,959)	205
12 Months or More	25,474,816	(317,272)	232	35,175,194	(713,311)	302
Total	28,070,721	(372,155)	439	39,788,793	(750,270)	507

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. Also, the Company is guaranteed payment of the principal amount of the securities by the respective issuing Agency.

During the quarter ended March 31, 2015, the Company disposed of $14.5 billion of Agency mortgage-backed securities, resulting in a net realized gain of $65.3 million. During the quarter ended March 31, 2014, the Company disposed of $4.3 billion of Agency mortgage-backed securities, resulting in a net realized gain of $129.5 million. Average cost is used as the basis on which the realized gain or loss on sale is determined.

Agency interest-only mortgage-backed securities represent the right to receive a specified portion of the contractual interest flows of the underlying outstanding principal balance of specific Agency mortgage-backed securities. Agency interest-only mortgage-backed securities in the Company's portfolio as of March 31, 2015 and December 31, 2014 had net unrealized gains (losses) of $(41.6) million and $(8.0) million and an amortized cost of $1.4 billion and $1.2 billion, respectively.

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5. COMMERCIAL REAL ESTATE INVESTMENTS

At March 31, 2015 and December 31, 2014, commercial real estate investments held for investment were composed of the following:

CRE Debt and Preferred Equity Investments

	March 31, 2015			December 31, 2014		
	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	431,872	430,228	28.7 %	384,304	383,895	25.2 %
Senior securitized mortgages(3)	361,861	361,179	24.1 %	399,541	398,634	26.3 %
Mezzanine loans	495,305	495,405	33.0 %	522,474	522,731	34.4 %
Preferred equity	213,213	211,594	14.2 %	214,653	212,905	14.1 %
Total	$ 1,502,251	$ 1,498,406	100.0 %	$ 1,520,972	$ 1,518,165	100.0 %

(1) Carrying value includes unamortized origination fees of $4.0 million and $3.0 million as of March 31, 2015 and December 31, 2014, respectively.
(2) Based on outstanding principal.
(3) Assets of consolidated VIEs.

	March 31, 2015				
	Senior Mortgages	Senior Securitized Mortgages(1)	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)				
Beginning balance	$ 383,895	$ 398,634	$ 522,731	$ 212,905	$ 1,518,165
Originations & advances (principal)	47,645	-	16,043	-	63,688
Principal payments	(76)	(37,680)	(43,212)	(1,441)	(82,409)
Sales (principal)	-	-	-	-	-
Amortization & accretion of (premium) discounts	(36)	-	(31)	25	(42)
Net (increase) decrease in origination fees	(1,950)	-	(236)	-	(2,186)
Amortization of net origination fees	750	225	110	105	1,190
Transfers	-	-	-	-	-
Allowance for loan losses	-	-	-	-	-
Net carrying value	$ 430,228	$ 361,179	$ 495,405	$ 211,594	$ 1,498,406

(1) Assets of consolidated VIE.

	December 31, 2014					
	Senior Mortgages	Senior Securitized Mortgages(1)	Subordinate Notes	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)					
Beginning balance	$ 667,299	$ -	$ 41,408	$ 628,102	$ 247,160	$ 1,583,969
Originations & advances (principal)	127,112	-	-	122,742	-	249,854
Principal payments	(12,756)	-	(41,059)	(227,151)	(35,116)	(316,082)
Sales (principal)	-	-	-	-	-	-
Amortization & accretion of (premium) discounts	(138)	-	(349)	(1,093)	108	(1,472)
Net (increase) decrease in origination fees	(2,427)	(116)	-	(478)	-	(3,021)
Amortization of net origination fees	2,783	772	-	609	753	4,917
Transfers	(397,978)	397,978	-	-	-	-
Allowance for loan losses	-	-	-	-	-	-
Net carrying value	$ 383,895	$ 398,634	$ -	$ 522,731	$ 212,905	$ 1,518,165

(1) Assets of consolidated VIE.

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Internal CRE Debt and Preferred Equity Investment Ratings

	March 31, 2015						
				Internal Ratings			
Investment Type	Outstanding Principal	Percentage of CRE Debt and Preferred Equity Portfolio		Performing	Watch List(2)	Defaulted-Recovery(3)	Impaired
				(dollars in thousands)			
Senior mortgages	$ 431,872	28.7	%	$ 188,899	$ 230,000	$ 12,973	$ -
Senior securitized mortgages(1)	361,861	24.1	%	352,611	9,250	-	-
Mezzanine loans	495,305	33.0	%	495,305	-	-	-
Preferred equity	213,213	14.2	%	162,213	51,000	-	-
	$ 1,502,251	100.0	%	$ 1,199,028	$ 290,250	$ 12,973	$ -

(1) Assets of consolidated VIE.
(2) Includes a $230.0 million loan maturing on June 30, 2015 with a risk that the borrower will be unable to refinance the outstanding principal amount before the maturity date, but full recovery is expected.
(3) Related to one loan on non-accrual status.

	December 31, 2014						
				Internal Ratings			
Investment Type	Outstanding Principal	Percentage of CRE Debt and Preferred Equity Portfolio		Performing	Watch List	Defaulted-Recovery(2)	Impaired
				(dollars in thousands)			
Senior mortgages	$ 384,304	25.2	%	$ 371,331	$ -	$ 12,973	$ -
Senior securitized mortgages(1)	399,541	26.3	%	390,291	9,250	-	-
Subordinate notes	-	0.0	%	-	-	-	-
Mezzanine loans	522,474	34.4	%	522,474	-	-	-
Preferred equity	214,653	14.1	%	214,653	-	-	-
	$ 1,520,972	100.0	%	$ 1,498,749	$ 9,250	$ 12,973	$ -

(1) Assets of consolidated VIE.
(2) Relates to one loan on nonaccrual status.

Real Estate Acquisitions

There were no acquisitions of real estate during the quarter ended March 31, 2015. The following table summarizes acquisitions of real estate held for

In November 2014, a joint venture, in which the Company has a 90% interest, acquired eleven retail properties located in New York, Ohio and Georgia. The purchase price was funded with cash and a new $104.0 million, ten-year, 4.03% fixed-rate interest-only mortgage loan.

investment in 2014:

Date of Acquisition	Type	Location	Purchase Price	Remaining Lease Term (Years) (1)
		(dollars in thousands)		
April 2014	Single-tenant retail	Tennessee	$ 19,000	8
June 2014	Multi-tenant retail	Virginia	$ 17,743	7
November 2014	Multi-tenant retail	New York, Ohio, Georgia	$ 154,000	4.6

(1) Does not include extension options.

The aforementioned acquisitions were accounted for using the acquisition method of accounting. No additional real estate acquisition costs were expensed during the period ended March 31, 2015.

The following table presents the aggregate allocation of the purchase price:

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	Tennessee	Virginia	Joint Venture	Total
		(dollars in thousands)		
Purchase Price Allocation:				
Land	$ 3,503	$ 6,394	$ 21,581	$ 31,478
Buildings	11,960	10,862	97,133	119,955
Site improvements	1,349	1,184	12,952	15,485
Tenant Improvements	-	-	9,601	9,601
Real estate held for investment	16,812	18,440	141,267	176,519
Intangible assets (liabilities):				
Leasehold intangible assets	4,288	3,218	22,555	30,061
Above market lease	-	-	5,463	5,463
Below market lease value	(2,100)	(3,915)	(15,285)	(21,300)
Total purchase price	$ 19,000	$ 17,743	$ 154,000	$ 190,743

The weighted average amortization period for intangible assets and liabilities is 3.7 years. Above market leases and leasehold intangible assets are included in Other assets and below market leases are included in Accounts payable and other liabilities in the Consolidated Statements of Financial Condition. The fair value of the 10% non-controlling interest in the joint venture at the acquisition date was $15.4 million.

The fair value of the acquisition and the related non-controlling interest was determined based on the purchase price.

Total Commercial Real Estate Investment at amortized cost

	March 31, 2015	December 31, 2014
	(dollars in thousands)	
Real estate held for investment, at amortized cost		
Land	$ 38,117	$ 38,117
Buildings and improvements	176,139	176,139
Subtotal	214,256	214,256
Less: accumulated depreciation	(7,047)	(4,224)
Total real estate held for investment at amortized cost, net	207,209	210,032
Total investment in commercial real estate, net	207,209	210,032
Net carrying value of CRE Debt and Preferred Equity Investments	1,498,406	1,518,165
Total commercial real estate investments, at amortized cost	$ 1,705,615	$ 1,728,197

Depreciation expense was $2.8 million and $0.3 million for the quarters ended March 31, 2015 and 2014, respectively, and is included in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss). The table below presents the minimum future

Rental Income

The minimum rental amounts due under the leases are generally either subject to scheduled fixed increases or adjustments. The leases generally also require that the rentals on noncancelable leases of the Company's commercial real estate investments as of March 31, 2015.

tenants reimburse us 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 March 31, 2015 for the consolidated properties, including consolidated joint venture properties are as follows (in thousands):

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	March 31, 2015 (dollars in thousands)
2015 (remaining)	$ 15,495
2016	18,684
2017	15,977
2018	13,620
2019	11,301
Later years	51,241
	$ 126,318

Mortgage loans payable as of March 31, 2015 and December 31, 2014, were as follows:

March 31, 2015

Property	Mortgage Carrying Value	Mortgage Principal	Interest Rate	Fixed/Floating Rate	Maturity Date	Priority
	(dollars in thousands)					
Joint Venture	$ 103,950	$ 103,950	4.03 %	Fixed	12/6/2024	First liens
Tennessee	12,350	12,350	4.01 %	Fixed	6/6/2019	First liens
Virginia	11,025	11,025	3.58 %	Fixed	9/6/2019	First liens
Arizona	16,644	16,548	3.50 %	Fixed	1/1/2017	First liens
Nevada	2,501	2,488	3.45 %	Floating (1)	3/29/2017	First liens
	$ 146,470	$ 146,361				

(1) Rate is fixed via an interest rate swap (pay fixed 3.45%, receive floating rate of L+200).

December 31, 2014

Property	Mortgage Carrying Value	Mortgage Principal	Interest Rate	Fixed/Floating Rate	Maturity Date	Priority
	(dollars in thousands)					
Joint Venture	$ 103,950	$ 103,950	4.03 %	Fixed	12/6/2024	First liens
Tennessee	12,350	12,350	4.01 %	Fixed	6/6/2019	First liens
Virginia	11,025	11,025	3.58 %	Fixed	9/6/2019	First liens
Arizona	16,709	16,600				