ANNALY CAPITAL MANAGEMENT INC
Form 10-K
February 27, 2014

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(MARK ONE)

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

FOR THE FISCAL YEAR ENDED: DECEMBER 31, 2013

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 of organization)	22-3479661 (I.R.S. Employer Identification Number)
1211 Avenue of the Americas, Suite 2902 New York, New York (Address of Principal Executive Offices)	10036 (Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $.01 per share	New York Stock Exchange
7.875% Series A Cumulative Redeemable Preferred Stock	New York Stock Exchange
7.625% Series C Cumulative Redeemable Preferred Stock	New York Stock Exchange

7.50% Series D Cumulative Redeemable Preferred Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None.

Indicate by check mark whether the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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

Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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 Act). Yes o No þ

At June 30, 2013, the aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately $11.9 billion.

The number of shares of the Registrant's Common Stock outstanding on February 10, 2014 was 947,463,924.

Documents Incorporated by Reference

The registrant intends to file a definitive proxy statement pursuant to Regulation 14A within 120 days of the end of the fiscal year ended December 31, 2013. Portions of such proxy statement are incorporated by reference into Part III of this Form 10-K.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

ANNALY CAPITAL MANAGEMENT, INC.
2013 FORM 10-K ANNUAL REPORT
TABLE OF CONTENTS

PART I

		PAGE
ITEM 1.	BUSINESS	1
ITEM 1A.	RISK FACTORS	10
ITEM 1B.	UNRESOLVED STAFF COMMENTS	34
ITEM 2.	PROPERTIES	34
ITEM 3.	LEGAL PROCEEDINGS	34
ITEM 4.	MINE SAFETY DISCLOSURES	34
	PART II	
ITEM 5.	MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES	35
ITEM 6.	SELECTED FINANCIAL DATA	38
ITEM 7.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	39
ITEM 7A.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	76
ITEM 8.	FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA	76
ITEM 9.	CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	- 76
ITEM 9A.	CONTROLS AND PROCEDURES	76
ITEM 9B.	OTHER INFORMATION	79

PART III

ITEM 10.	DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE	80
ITEM 11.	EXECUTIVE COMPENSATION	80
ITEM 12.	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS	80
ITEM 13.	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE	80
ITEM 14.	PRINCIPAL ACCOUNTING FEES AND SERVICES	80
	PART IV	
ITEM 15.	EXHIBITS, FINANCIAL STATEMENT SCHEDULES	81
EXHIBIT INDEX		81
FINANCIAL STATEMENTS		84
SIGNATURES		II-1

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Business

PART I

ITEM 1. BUSINESS

Annaly," "we," "us," or "our" refers to 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 Glossary of Terms for definitions of certain of the commonly used terms in this annual report on Form 10-K.

INDEX TO ITEM 1. BUSINESS

	Page
Business Overview	2
Investment Strategy	2
Target Assets	3
Our Portfolio	5
Capital Structure	5
Risk Management	6
Management Agreement	6
Executive Officers	7
Employees	8
Regulatory Requirements	8
Competition	8
Distributions	8
Available Information	9

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Business

Business Overview

We are a leading mortgage real estate investment trust (or REIT) that is externally managed by Annaly Management Company LLC (or Manager). Our common stock is listed on the New York Stock Exchange under the ticker symbol “NLY”. Since our founding in 1997, we have strived to generate net income for distribution to our stockholders through the prudent selection and management of our investments. We own a portfolio of real estate related investments. We use our capital coupled with borrowed funds to invest in real estate related investments, earning the spread between the yield on our assets and the cost of our borrowings.

Our business operations are primarily comprised of the following:

Annaly, the parent company	Invests primarily in various types of Agency mortgage-backed securities and related derivatives to hedge these investments.
Annaly Commercial Real Estate Group, Inc. (or ACREG) (formerly known as CreXus Investment Corp.)	Wholly-owned subsidiary that was acquired during the second quarter of 2013 and specializes in acquiring, financing and managing commercial mortgage loans and other commercial real estate debt, commercial mortgage-backed securities and other commercial real estate-related assets.
RCap Securities, Inc. (or RCap)	Wholly-owned subsidiary that operates as a broker-dealer, and is a member of the Financial Industry Regulatory Authority (or FINRA).
Fixed Income Discount Advisory Company (or FIDAC)	Wholly-owned subsidiary that manages an affiliated REIT for which it earns fee income.
Annaly Middle Market Lending LLC (or MML)	Wholly-owned subsidiary that engages in corporate middle market lending transactions.
Shannon Funding LLC (or Shannon)	Wholly-owned subsidiary that acquires residential mortgage loans and provides warehouse financing to residential mortgage originators in the United States.

We believe that our business objectives are supported by our size and conservative financial posture, the extensive experience of our Manager’s employees, a comprehensive risk management approach, the availability and diversification of financing sources, our corporate structure and our cost efficiencies.

Investment Strategy

We own a portfolio of real estate related investments, including mortgage pass-through certificates, CMOs, Agency callable debentures, other securities representing interests in or obligations backed by pools of mortgage loans, commercial real estate

assets and corporate debt. Our principal business objective is to generate net income for distribution to our stockholders from our investments. Under our investment policy, at least 75% of our total assets are comprised of high-quality mortgage-backed securities and short-term investments. High quality securities are:

rated within one of the two highest rating categories by at least one of the nationally recognized rating agencies;

unrated but are guaranteed by the United States government or by an agency of the United States government; or

unrated but we determine them to be of comparable quality to high-quality rated mortgage-backed securities.

The remainder of our assets may generally consist of other qualified REIT real estate assets. In addition, we may directly or indirectly invest part of our assets in other types of securities, including, unrated debt and equity securities and derivative instruments, to the extent consistent with our REIT qualification requirements.

We may acquire Agency mortgage-backed securities backed by single-family residential mortgage loans as well as securities backed by loans on multi-family, commercial or other real estate related properties. As part of our current diversification strategy, we may allocate up to 25% of our stockholders' equity to real estate assets other than Agency mortgage-backed securities.

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

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

Portfolio composition	We will maintain a high quality asset portfolio with (1) at least 75% of the portfolio to be high quality mortgage-backed securities and short term investments (equivalency rating of AA+ or better) and (2) an aggregate weighted average equivalency rating of single "A" or better.
Leverage	We will operate at a debt-to-equity ratio no greater than 12:1.
Capital buffer	We will maintain an excess capital buffer, of which at least 25% will be invested in AAA rated mortgage-backed securities (or assets of similar or better liquidity characteristics), to meet the liquidity needs of the firm.
Interest rate risk	We will manage interest rate risk to protect the portfolio from adverse rate movements.
Hedging	We will use swaps and other derivatives to hedge market risk, targeting both income and capital preservation.
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 of 1940, as amended (or Investment Company Act).

Our board of directors has reviewed and approved the investment and operating policies and strategies

We may seek to expand our capital base in order to further increase our ability to acquire new and different

established by our Manager and set forth in this Form 10-K. The board of directors has the power to modify or waive these policies and strategies without the consent of the stockholders to the extent that the board of directors determines that the modification or waiver is in the best interests of our stockholders. Among other factors, developments in the market which affect our policies and strategies or which change our assessment of the market may cause our board of directors to revise our policies and strategies.

types of assets when the potential returns from new investments appear attractive relative to the targeted risk-adjusted returns. We may in the future acquire assets by offering our debt or equity securities in exchange for the assets.

Target Assets

Within the confines of the risk appetite statement, we seek to generate the highest risk-adjusted returns on capital invested, after consideration of the following:

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Business

The amount, nature and variability of anticipated cash flows from the asset across a variety of interest rate, yield spread, financing cost, credit loss and prepayment scenarios;

The liquidity of the asset;

The ability to pledge the asset to secure collateralized borrowings;

When applicable, the credit of the underlying borrower;

The costs of financing, hedging and managing the asset;

The impact of the asset to our REIT compliance and our exemption from the Investment Company Act; and

The capital requirements associated with the purchase and financing of the asset.

We target the purchase and sale of the following assets as part of our investment strategy. Our targeted assets and asset acquisition strategy may change over time as market conditions change and as our business evolves.

Targeted Asset Class	Description
Agency mortgage-backed securities	Our primary investments consist of Agency pass-through certificates, CMOs issued or guaranteed by Freddie Mac, Fannie Mae or Ginnie Mae, interest-only securities and inverse floaters. These securities are backed by single-family or multi-family residences with loans typically ranging from 15 to 40 years and may have fixed or floating coupons.
To-be-announced forward contracts (or TBAs)	We purchase and sell TBAs which are forward contracts for Agency mortgage-backed securities. These have specified principal and interest terms and specify certain types of collateral, but the particular Agency mortgage-backed securities to be delivered are not identified until shortly before the TBA settlement date.
Agency debentures	We invest in debt issued by Freddie Mac, Fannie Mae or the Federal Home Loan Banks. These debentures are not backed by collateral, but by the creditworthiness of the issuer.
Commercial real estate	Through our subsidiary ACREG, we originate and acquire commercial real estate debt including commercial mortgage loans, commercial mortgage-backed securities, B-notes, mezzanine loans, preferred equity and other commercial real estate-related debt investments. We also

	invest in commercial real estate property directly or as a result of a loan workout and the exercise of our remedies under the mortgage documents.
Other mortgage related investments	On a limited basis we may invest in other mortgage related investments including: investments in individual residential loans, pools of loans, single-family and multi-family privately-issued certificates that are not issued by one of the Agencies.
Corporate debt	Through our subsidiary MML, we invest a small percentage of our assets directly in the ownership of corporate loans for middle market companies.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Business

We generally hold assets we acquire until maturity. We believe that future interest rates and mortgage prepayment rates are very difficult to predict. Therefore, we seek to acquire assets which we believe will provide attractive returns over a broad range of interest rate and prepayment scenarios.

Our Portfolio

Our portfolio composition as of December 31, 2013 and 2012 was as follows:

Asset Portfolio (using balance sheet values)

Category	2013	2012
Agency mortgage-backed securities(1)	93.7%	97.5%
Agency debentures	4.0%	2.4%
Commercial real estate debt and equity	2.1%	0.0%
Other mortgage-backed securities	0.0%	0.0%
Corporate debt, held for investment	0.2%	0.1%

(1) Includes TBAs held for delivery.

Capital Structure

Our capital structure is designed to offer an efficient compliment of funding sources to generate positive risk-adjusted returns for our stockholders while maintaining appropriate liquidity to support our business and meet our financial obligations under periods of market stress. We utilize a mix of debt and equity funding. Debt funding may include the use of repurchase agreements, loans, securitizations, participations sold, lines of credit, asset backed commercial paper conduits, corporate bond issuance, or other liabilities. Equity capital primarily consists of common and preferred stock.

We finance our Agency mortgage-backed securities with repurchase agreements. We enter into repurchase agreements primarily with national broker-dealers, commercial banks and other lenders that typically offer this type of financing. We enter into collateralized borrowings with financial institutions meeting internal credit standards and we monitor the financial condition of these institutions on a regular basis. We seek to diversify our exposure and limit concentrations by entering into repurchase agreements with multiple counterparties. At December 31, 2013, we had $61.8

Equity capital is made up primarily of common stock. It also consists of preferred stock and may in the future include the use of other equity capital issuance.

We generally expect to maintain a ratio of debt-to-equity of no greater than 12:1. This ratio varies from time to time based upon various factors, including our management’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. Since the financial crisis beginning in 2007, we have maintained a debt-to-equity ratio of below 8:1, which is generally lower than our debt-to-equity ratio had been prior to 2007. For purposes of calculating this ratio, our debt is equal to our repurchase agreements, convertible senior notes, loan participation sold and mortgages payable as presented on our Consolidated Statements of Financial Condition.

Our target debt-to-equity ratio is determined under our capital management policy. Should our actual debt-to-equity ratio increase above the target level due to asset acquisition or market value fluctuations in

billion of repurchase agreements outstanding.

Our borrowings pursuant to repurchase transactions have maturities that range from overnight to greater than five years. While shorter term agreements generally have lower interest rates, they increase liquidity risk. To reduce our liquidity risk we maintain a laddered approach to our repurchase agreements and a conservative weighted average days to maturity. As of December 31, 2013, the weighted average days to maturity was 204 days.

assets, we would cease to acquire new assets. Our management would, at that time, present a plan to our board of directors to return to our target debt-to-equity ratio.

The following table presents our debt-to-equity, capital and net capital ratios at December 31, 2013 and 2012.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Business

	2013	2012
Debt-to-equity ratio	5.0:1	6.5:1
Capital ratio	15.1%	11.9%
Net capital ratio	15.9%	12.3%

Risk Management

Risk is a natural element of the business and related activities that we conduct. Effective risk management is of critical importance to the success of the firm. The objective of our risk management framework is to measure, monitor and manage the key risks to which we are subject. Our approach to risk management is comprehensive and has been designed to foster a holistic view of risk. For a full discussion of our risk management process and policies please refer to the section titled "Risk Management" of Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations".

Management Agreement

At our annual stockholders' meeting on May 23, 2013, our stockholders approved the entry by us into a management agreement, between us and our Manager and the externalization of our company's management function effective as of July 1, 2013. Under the terms of the management agreement, the Manager is responsible for administering our business activities and day-to-day operations, subject to the supervision and oversight of our board. The Manager is supervised and directed by our board and is responsible for (i) the selection, purchase and sale of our investment portfolio; (ii) our financing and hedging activities; and (iii) providing us with management services. The Manager performs such other services and activities relating to our assets and operations as may be appropriate. In exchange for these services, the Manager receives a management fee paid monthly in arrears in an amount equal to one-twelfth of 1.05% of our stockholders' equity (as defined in the management agreement).

Effective July 1, 2013, a majority of our employees were terminated by us and were hired by the Manager. We

The management agreement provides that the Manager is prohibited from managing, operating, joining, controlling, participating in, or advising any real estate investment trust whose principal business strategy is based on or engaged in the trading, sales or management of mortgage-backed securities in any geographical region in which we engage in such business.

The management agreement may be amended or modified by agreement between us and the Manager. The initial term of the management agreement expires on December 31, 2014 and will be automatically renewed for a one year term each anniversary date thereafter unless previously terminated as described below. There is no termination fee for a termination of the management agreement by either us or the Manager.

Two-thirds of our independent directors or the holders of a majority of the outstanding shares of common stock may terminate the management agreement for any or no reason, at any time upon one hundred eighty (180) days prior written notice. The Manager may also terminate the management agreement upon one hundred eighty (180) days prior written notice.

We may terminate the management agreement effective immediately upon written notice from us to the Manager for cause. These events include fraud, embezzlement, gross negligence, material breach of the management agreement not cured within a specified time period and the Manager's bankruptcy or dissolution. In addition, the management agreement provides for automatic termination upon a sale of the Manager without the prior consent of the independent members of our board of directors.

The Manager may terminate the management agreement effective immediately upon written notice in the event of a material breach of the management agreement by us

have a limited number of employees following the externalization of management, all of whom are employees of our subsidiaries for regulatory or corporate efficiency reasons. All compensation expenses associated with such retained employees reduce the management fee. We pay directly, or reimburse the Manager, for all of our expenses and all the Manager's documented expenses incurred on our behalf, other than compensation and benefits related to any and all personnel of the Manager and costs of certain insurance with respect to such personnel.

that is not cured within a specified time period. The Manager may also terminate the management agreement in the event we become required to register as an "investment company" under the Investment Company Act, with such termination deemed to have occurred immediately prior to such event.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Business

Executive Officers

Our executive officers are provided and compensated by our Manager. The following table sets forth certain information as of February 25, 2014 concerning our executive officers:

Name	Age	Title
Wellington J. Denahan	50	Chairman of the Board and Chief Executive Officer
Kevin G. Keyes	46	President and Director
Glenn A. Votek	55	Chief Financial Officer
James P. Fortescue	40	Chief Operating Officer
R. Nicholas Singh	55	Chief Legal Officer and Secretary
Rose-Marie Lyght	40	Co-Chief Investment Officer
Kristopher R. Konrad	39	Co-Chief Investment Officer

Wellington J. Denahan is Chairman of the Board and Chief Executive Officer of Annaly. Ms. Denahan was appointed Chairman of the Board and Chief Executive Officer of Annaly in November 2012. Previously, Ms. Denahan was appointed to serve as Co-Chief Executive Officer of Annaly in October 2012. Ms. Denahan was elected in December 1996 to serve as Vice Chairman of the Board. Ms. Denahan was Annaly's Chief Operating Officer from January 2006 to October 2012 and Chief Investment Officer from 2000 to November 2012. She was a co-founder of Annaly. Ms. Denahan has a B.A. in Finance from Florida State University. She currently chairs the mortgage REIT council at National Association of Real Estate Investment Trusts (NAREIT).

Kevin G. Keyes is President of Annaly and a member of the Board of Directors. Prior to being named to his

Group where he was an Executive Vice President and Treasurer since 1999 and President of Consumer Finance since 2012. Prior to that, Mr. Votek worked at AT&T and its finance subsidiary from 1986 until 1999 in various financial management roles. Mr. Votek has a B.S. in Finance and Economics from the University of Arizona/Kean College and a M.B.A. in Finance from Rutgers University.

James P. Fortescue was appointed to serve as Chief Operating Officer of Annaly and FIDAC in October 2012. Mr. Fortescue was previously Chief of Staff, Head of Liabilities and Managing Director of Annaly. Mr. Fortescue joined FIDAC in June of 1995. Mr. Fortescue has been in charge of liability management for Annaly since its inception, and continues to oversee all financing activities for FIDAC. Mr. Fortescue has a B.S. in Finance from Siena College.

current role, Mr. Keyes served as Chief Strategy Officer and Head of Capital Markets at Annaly. Mr. Keyes has over 20 years of Capital Markets and Investment Banking experience. He joined Annaly in 2009 from Bank of America Merrill Lynch where he served in various senior management and business origination roles since 2005. Prior to that, Mr. Keyes also worked at Credit Suisse First Boston from 1997 until 2005 in various capital markets roles and Morgan Stanley Dean Witter from 1990 until 1997 in various investment banking positions. Mr. Keyes has a B.A. in Economics and a B.S. in Business Administration (ALPA Program) from the University of Notre Dame.

Glenn A. Votek was appointed to serve as Chief Financial Officer of Annaly and FIDAC in August 2013. Mr. Votek joined Annaly in May 2013 from CIT

R. Nicholas Singh is Chief Legal Officer and Secretary of Annaly and FIDAC. Mr. Singh was employed by Annaly in February 2005. From 2001 until he joined Annaly, he was a partner in the law firm of McKee Nelson LLP. Mr. Singh has a B.A. from Carleton College, a M.A. from Columbia University and a J.D. from American University.

Rose-Marie Lyght was appointed to serve as Co-Chief Investment Officer of Annaly and FIDAC in November 2012. Ms. Lyght was previously a Managing Director of Annaly and Chief Investment Officer of FIDAC. She has been involved in the asset selection and financing for the investment vehicles managed by FIDAC. Ms. Lyght was employed by Annaly in April 1999. Ms. Lyght has a B.S. in Finance and a M.B.A. from Villanova University.

Kristopher R. Konrad was appointed to serve as Co-Chief Investment Officer of Annaly and FIDAC in November 2012. Mr. Konrad was previously a Managing Director and Head Portfolio Manager of Annaly. Mr. Konrad joined in October 1997 and became a Portfolio Manager for Annaly in December of 2000. Mr. Konrad has a B.S. in Business from Ithaca College and has attended the New York Institute of Finance for intensive mortgage-backed securities studies.

Employees

Effective July 1, 2013, all of Annaly's employees were terminated by us and were hired by the Manager. However, a limited number of employees of our subsidiaries remain as employees of our subsidiaries for regulatory or corporate efficiency reasons. As of December 31, 2013, our subsidiaries employed 48 employees. All compensation expenses associated with the employees of our subsidiaries reduce the management fee.

Regulatory Requirements

We have elected and believe that we are organized and have operated in a manner that qualifies us to be taxed as a REIT under the Internal Revenue Code of 1986, as amended and regulations promulgated thereunder (or the Code). If we qualify for taxation as a REIT, we generally will not be subject to federal income tax on our taxable income that is distributed to our stockholders. Furthermore, substantially all of our assets, other than our taxable REIT subsidiaries, consist of qualified REIT real estate assets (of the type described in Section 856(c)(5) of the Code).

We regularly monitor our investments and the income from these investments and, to the extent we enter into hedging transactions, we monitor income from our hedging transactions as well, so as to ensure at all times that we maintain our qualification as a REIT and our exemption from registration under the Investment Company Act.

institutions have been subject to increasing regulation and supervision in the U.S. In particular, the Dodd-Frank Act, which was enacted in July 2010, significantly altered the financial regulatory regime within which financial institutions operate. The implications of the Dodd-Frank Act for our business will depend to a large extent on the rules that will be adopted by the Federal Reserve Board, the FDIC, the Securities and Exchange Commission (or SEC), the Commodities and Futures Trading Commission (or CFTC) and other agencies to implement the legislation, as well as the development of market practices and structures under the regime established by the legislation and the implementation of the rules. Other reforms have been adopted or are being considered by other regulators and policy makers worldwide. We will continue to assess our business, risk management, and compliance practices to conform to developments in the regulatory environment.

Competition

We operate in a highly competitive environment. Our principal competition in the acquisition and holding of the types of assets we purchase are financial institutions such as banks, savings and loans, life insurance companies, institutional investors such as mutual funds and pension funds, other lenders, government entities and certain other mortgage REITs. Some of these entities may not be subject to the same regulatory constraints (i.e., REIT compliance or maintaining an exemption under the Investment Company Act) as us. Some of our competitors have greater financial resources and access to capital than we do. Our competitors, as well as additional competitors which may emerge in the future, may increase the competition for the acquisition of our target assets, which in turn may result in higher prices and lower yields on such assets.

Distributions

As a requirement for maintaining REIT status, we will distribute to stockholders aggregate dividends equaling at least 90% of our REIT taxable income for each

RCap is a member of FINRA and 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, RCap is required to maintain minimum net capital by FINRA. RCap consistently operates with capital in excess of its regulatory capital requirements as defined by SEC Rule 15c3-1.

The financial services industry has been the subject of intense regulatory scrutiny in recent years. Financial

taxable year. We may make additional returns of capital when the potential risk-adjusted returns from new investments fail to exceed our cost of capital. Subject to the limitations of applicable securities and state corporation laws, we can return capital by making purchases of our own capital stock or through payment of dividends.

Available Information

Our website is www.annaly.com. We make available on this website under "Investor Relations - SEC Filings," free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we electronically file or furnish such materials to the SEC.

Also posted on our website, and available in print upon request of any stockholder to our Investor Relations Department, are charters for our Audit Committee, Risk Committee, Compensation Committee, and Nominating/Corporate Governance Committee, our Corporate Governance Guidelines and our Code of Business Conduct and Ethics governing our directors and officers as well as the employees of our subsidiaries and our Manager. Within the time period required by the SEC, we will post on our website any amendment to the Code of Business Conduct and Ethics and any waiver applicable to any executive officer, director or senior financial officer.

Our Investor Relations Department can be contacted at:

Annaly Capital Management, Inc.
1211 Avenue of the Americas, Suite 2902
New York, New York 10036
Attn: Investor Relations
Telephone: 888-8ANNALY
E-mail: investor@annaly.com.

The SEC also maintains a website that contains reports, proxy and information statements and other information we file with the SEC at www.sec.gov. Copies of these reports, proxy and information statements and other information may also be obtained, after paying a duplicating fee, by electronic request at publicinfo@sec.gov, or by writing the SEC's Public Reference Section, 100 F Street, N.E., Washington, D.C. 20549-0102. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Risk Factors

ITEM 1A. RISK FACTORS

An investment in our stock involves a number of risks. Before making an investment decision, you should carefully consider all of the risks described in this Form 10-K. If any of the risks discussed in this Form 10-K actually occur, our business, financial condition and results of operations could be materially adversely affected. If this were to occur, the trading price of our stock could decline significantly and you may lose all or part of your investment. Readers should not consider any descriptions of these factors to be a complete set of all potential risks that could affect us.

INDEX TO ITEM 1A. RISK FACTORS

	Page
Risks Related to Our Investing, Portfolio Management and Financing Activities	10
Risks Related to Commercial Real Estate Debt, Preferred Equity Investments and Net Lease Real Estate Assets	18
Risks Related to Our Relationship with Our Manager	25
Risks Related to Our Taxation as a REIT	25
Risks of Ownership of Our Common Stock	30
Regulatory Risks	32

Risks Related to Our Investing, Portfolio Management and Financing Activities

We may change our policies without stockholder approval.

Our Manager is authorized to follow very broad investment guidelines that may be amended from time to time. Our board of directors and management determine all of our significant policies, including our investment, financing and distribution policies. They may amend or revise these policies at any time without a vote of our stockholders. Policy changes could adversely affect our financial condition, results of operations, the market price of our common stock or our ability to pay dividends or distributions.

Our ongoing investment in new business strategies and new assets is inherently risky, and could disrupt our ongoing businesses.

equity to real estate assets other than Agency mortgage-backed securities. These other assets expose us to other sorts of risk, including credit risk.

Such endeavors may involve significant risks and uncertainties, including credit risk, diversion of management from current operations, expenses associated with these new investments, inadequate return of capital on our investments, and unidentified issues not discovered in our due diligence of such strategies and assets. Because these new ventures are inherently risky, no assurance can be given that such strategies will be successful and will not materially adversely affect our reputation, financial condition, and operating results.

Our strategy involves the use of leverage, which increases the risk that we may incur substantial losses.

We expect our leverage to vary with market conditions

To date our total assets have consisted primarily of Agency mortgage-backed securities and Agency debentures which carry an implied or actual "AAA" rating. Nevertheless, pursuant to our investment policy, we have the ability to acquire assets of lower credit quality.

While we remain committed to the Agency market, given the current environment, we believe it is prudent to diversify a portion of our investment portfolio. We have begun investing in new business strategies and assets and expect to continue to do so in the future. We currently may allocate up to 25% of our stockholders' and our assessment of risk/return on investments. We incur this leverage by borrowing against a substantial portion of the market value of our assets. By incurring this leverage, we could enhance our returns. Nevertheless, leverage, which is fundamental to our investment strategy, also creates significant risks.

Because of our leverage, we may incur substantial losses if our borrowing costs increase. Our borrowing costs may increase for any of the following reasons:

short-term interest rates increase;
the market value of our investments decreases;

- the "haircut" applied to our assets under the repurchase agreements we are party to increases;
- interest rate volatility increases; or
- the availability of financing in the market decreases.

Our leverage may cause margin calls and defaults and force us to sell assets under adverse market conditions.

Because of our leverage, a decline in the value of our interest earning assets may result in our lenders initiating margin calls. A margin call means that the lender requires us to pledge additional collateral to re-establish the ratio of the value of the collateral to the amount of the borrowing. Our fixed-rate mortgage-backed securities generally are more susceptible to margin calls as increases in interest rates tend to more negatively affect the market value of fixed-rate securities.

If we are unable to satisfy margin calls, our lenders may foreclose on our collateral. This could force us to sell our interest earning assets under adverse market conditions. Additionally, in the event of our bankruptcy, our borrowings, which are generally made under repurchase agreements, may qualify for special treatment under the Bankruptcy Code. This special treatment would allow the lenders under these agreements to avoid the automatic stay provisions of the Bankruptcy Code and to liquidate the collateral under these agreements without delay.

We may exceed our target leverage ratios.

We generally expect to maintain a ratio of debt-to-equity of less than 12:1. However, we are not required to stay below this leverage ratio. We may exceed this ratio by incurring additional debt without increasing the amount of equity we have. For example, if we increase the amount of borrowings under our master repurchase agreements with our existing or new counterparties, our leverage ratio would increase. If we increase our debt-to-equity ratio, the adverse impact on our financial condition and results of operations from our lenders require that we provide additional collateral to cover our borrowings.

Failure to procure or renew funding on favorable terms, or at all, would adversely affect our results and financial condition.

One or more of our lenders could be unwilling or unable to provide us with financing. This could potentially increase our financing costs and reduce our liquidity. If one or more major market participants fails or otherwise experiences a major liquidity crisis it could negatively impact the marketability of all fixed income securities, including Agency mortgage-backed securities, and this could negatively impact the value of the securities we acquire, thus reducing our net book value. Furthermore, if any of our potential lenders or existing lenders is unwilling or unable to provide us with financing or if we are not able to renew or replace maturing borrowings, we could be forced to sell our assets at an inopportune time when prices are depressed.

Purchases and sales of Agency mortgage-backed securities by the Federal Reserve may adversely affect the price and return associated with Agency mortgage-backed securities.

On September 13, 2012, the Federal Reserve announced their third quantitative easing program, commonly known as QE3, and extended their guidance to keep the federal funds rate at “exceptional low levels” through at least mid-2015. QE3 entails large-scale purchases of Agency mortgage-backed securities at the pace of $40 billion per month in addition to the Federal Reserve's existing policy of reinvesting principal payments from its holdings of Agency mortgage-backed securities into new Agency mortgage-backed securities purchases. While we cannot predict the impact of this program or any future actions by the Federal Reserve on the prices and liquidity of Agency mortgage-backed securities, we expect that during periods in which the Federal Reserve purchases significant volumes of Agency mortgage-backed

the types of risks associated with the use of leverage would likely be more severe.

We may not be able to achieve our optimal leverage.

We use leverage as a strategy to increase the return to our investors. However, we may not be able to achieve our desired leverage for any of the following reasons:

we determine that the leverage would expose us to excessive risk;

our lenders do not make funding available to us at acceptable rates; or

securities, yields on Agency mortgage-backed securities will be lower and refinancing volumes will be higher than would have been absent their large scale purchases. As a result, returns on Agency mortgage-backed securities may be adversely affected. There is also a risk that as the Federal Reserve reduces their purchases of Agency mortgage-backed securities or if they decide to sell some or all of their holdings of Agency mortgage-backed securities, the pricing of our Agency mortgage-backed securities portfolio may be adversely affected. On December 18, 2013, the Federal Reserve

announced that beginning in January 2014 it will add to its holdings of Agency mortgage-backed securities at a pace of $35 billion per month rather than $40 billion per month, and will add to its holdings of longer-term Treasury securities at a pace of $40 billion per month rather than $45 billion per month. On January 29, 2014, the Federal Reserve announced that beginning in February, it will add to its holdings of Agency mortgage-backed securities at a pace of $30 billion per month rather than $35 billion per month, and will add to its holdings of longer-term Treasury securities at a pace of $35 billion per month rather than $40 billion per month. These actions, commonly referred to as the "tapering" of the Federal Reserve's purchase program, may adversely impact our book value.

New laws may be passed affecting the relationship between Fannie Mae and Freddie Mac, on the one hand, and the federal government, on the other, which could adversely affect the price of Agency mortgage-backed securities.

The interest and principal payments we expect to receive on the Agency mortgage-backed securities in which we invest will be guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. Principal and interest payments on Ginnie Mae certificates are directly guaranteed by the U.S. government. Principal and interest payments relating to the securities issued by Fannie Mae and Freddie Mac are only guaranteed by each respective Agency.

Since September 2008, there have been increased market concerns about the ability of Fannie Mae and Freddie Mac to withstand future credit losses associated with securities held in their investment portfolios, and on which they provide guarantees, without the direct support of the federal government. Fannie Mae and Freddie Mac were placed into the conservatorship of the Federal Housing Finance Agency, or FHFA, their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008.

re-examined. The future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantees could be eliminated or considerably limited relative to historical measurements. The U.S. Treasury could also stop providing credit support to Fannie Mae and Freddie Mac in the future. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes an Agency mortgage-backed security and could have broad adverse market implications. On June 25, 2013, a bipartisan group of U.S. Senators introduced a draft bill titled, "Housing Finance Reform and Taxpayer Protection Act of 2013," which may serve as a catalyst for congressional discussion on the reform of Fannie Mae and Freddie Mac, to the U.S. Senate. Also, on July 11, 2013, members of the House Committee on Financial Services introduced a draft bill titled, "Protecting American Taxpayers and Homeowners Act" to the U.S. House of Representatives. Both bills call for the winding down of Fannie Mae and Freddie Mac and seek to increase the opportunities for private capital to participate in, and consequently bear the risk of loss in connection with, government-guaranteed mortgage-backed securities. If Fannie Mae or Freddie Mac were eliminated, or their structures were to change radically, we would not be able to acquire Agency mortgage-backed securities from these entities, which could adversely affect our business operations.

The U.S. Government's efforts to encourage refinancing of certain loans may affect prepayment rates for mortgage loans in mortgage-backed securities.

In addition to the increased pressure upon residential mortgage loan investors and servicers to engage in loss mitigation activities, the U.S. Government is pressing for refinancing of certain loans, and this action may affect prepayment rates for mortgage loans in Agency mortgage-backed securities. To the extent these and other economic stabilization or stimulus efforts are successful in increasing prepayment speeds for residential mortgage loans, such as those in Agency mortgage-backed securities, such efforts could potentially have a negative impact on our income and operating results, particularly in connection with loans

In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, the U.S. Department of the Treasury has taken various actions intended to provide Fannie Mae and Freddie Mac with additional liquidity and ensure their financial stability.

Shortly after Fannie Mae and Freddie Mac were placed in federal conservatorship, the Secretary of the U.S. Treasury suggested that the guarantee payment structure of Fannie Mae and Freddie Mac should be

or Agency mortgage-backed securities purchased at a premium or our interest-only securities.

Volatile market conditions for mortgages and mortgage-related assets as well as the broader financial markets can result in a significant contraction in liquidity for mortgages and mortgage-related assets, which may adversely affect the value of the assets in which we invest.

Our results of operations are materially affected by conditions in the markets for mortgages and mortgage-related assets, including Agency mortgage-backed securities, as well as the broader financial markets and the economy generally.

Significant adverse changes in financial market conditions can result in a deleveraging of the global financial system and the forced sale of large quantities of mortgage-related and other financial assets. Concerns over economic recession, geopolitical issues, unemployment, the availability and cost of financing, the mortgage market and a declining real estate market may contribute to increased volatility and diminished expectations for the economy and markets.

For example, as a result of the financial market conditions beginning in the summer of 2007, many traditional mortgage investors suffered severe losses in their residential mortgage portfolios and several major market participants failed or have been impaired, resulting in a significant contraction in market liquidity for mortgage-related assets. This illiquidity negatively affected both the terms and availability of financing for all mortgage-related assets. Further increased volatility and deterioration in the markets for mortgages and mortgage-related assets as well as the broader financial markets may adversely affect the performance and market value of our Agency mortgage-backed securities. If these conditions persist, institutions from which we seek financing for our investments may tighten their lending standards or become insolvent, which could make it more difficult for us to obtain financing on favorable terms or at all. Our profitability and financial condition may be adversely affected if we are unable to obtain cost-effective financing for our investments.

We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments in our target assets and could also affect the pricing of these securities.

other resources than we do. Several other REITs have recently raised, or are expected to raise, significant amounts of capital, and may have investment objectives that overlap with ours, which may create additional competition for investment opportunities. Some competitors may have a lower cost of funds and access to funding sources that may not be available to us, such as funding from the U.S. Government. Many of our competitors are not subject to the operating constraints associated with REIT tax compliance or maintenance of an exemption from the Investment Company Act. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, competition for investments in our target assets may lead to the price of such assets increasing, which may further limit our ability to generate desired returns. We cannot provide assurance that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. Also, as a result of this competition, desirable investments in our target assets may be limited in the future and we may not be able to take advantage of attractive investment opportunities from time to time, as we can provide no assurance that we will be able to identify and make investments that are consistent with our investment objectives.

An increase in the interest payments on our borrowings relative to the interest we earn on our interest earning assets may adversely affect our profitability.

We earn money based upon the spread between the interest payments we earn on our interest earning assets and the interest payments we must make on our borrowings. If the interest payments on our borrowings increase relative to the interest we earn on our interest earning assets, our profitability may be adversely affected.

Differences in timing of interest rate adjustments on our interest earning assets and our borrowings may adversely affect our profitability.

We operate in a highly competitive market for investment opportunities. Our profitability depends, in large part, on our ability to acquire our target assets at attractive prices. In acquiring our target assets, we will compete with a variety of institutional investors, including other REITs (as well as another REIT externally managed by our wholly owned subsidiary, FIDAC), specialty finance companies, public and private funds, government entities, commercial and investment banks, commercial finance and insurance companies and other financial institutions. Many of our competitors are substantially larger and have considerably greater financial, technical, marketing and

We rely primarily on short-term borrowings to acquire interest earning assets with long-term maturities. Some of the interest earning assets we acquire are adjustable-rate interest earning assets. This means that their interest rates may vary over time based upon changes in an objective index, such as:

LIBOR. The interest rate that banks in London offer for deposits in London of U.S. dollars.

Treasury Rate. A monthly or weekly average yield of benchmark U.S. Treasury securities, as published by the Federal Reserve Board.

These indices generally reflect short-term interest rates. The interest rates on our borrowings similarly vary with changes in an objective index. Nevertheless, the interest rates on our borrowings generally adjust more frequently than the interest rates on our adjustable-rate interest earning assets, which are also typically subject to periodic and lifetime interest rate caps. Accordingly, in a period of rising interest rates, we could experience a decrease in net income or a net loss because the interest rates on our borrowings adjust faster than the interest rates on our adjustable-rate interest earning assets.

An increase in interest rates may adversely affect the market value of our interest earning assets and, therefore, also our book value.

Increases in interest rates may negatively affect the market value of our interest earning assets because in a period of rising interest rates, the value of certain interest earning assets may fall and reduce our book value. In addition, our fixed-rate interest earning assets are generally more negatively affected by increases in interest rates because in a period of rising rates, the coupon we earn on our fixed-rate interest earning assets would not change. Our book value would be reduced by the amount of decreases in the market value of our interest earning assets.

We may experience declines in the market value of our assets resulting in us recording impairments, which may have an adverse effect on our results of operations and financial condition.

A decline in the market value of our mortgage-backed securities or other assets may require us to recognize an "other-than-temporary" impairment (OTTI) against such assets under GAAP. When the fair value of our mortgage-backed securities is less than its amortized cost, the security is considered impaired. We assess our remainder recognized as a component of other comprehensive income/(loss) on our balance sheet. Impairments we recognize through other comprehensive income/(loss) do not impact our earnings. Following the recognition of an other-than-temporary impairment through earnings, a new cost basis is established for the mortgage-backed security and may not be adjusted for subsequent recoveries in fair value through earnings. However, other-than-temporary impairments recognized through earnings may be accreted back to the amortized cost basis of the security on a prospective basis through interest income upon a subsequent recovery of expected cash flows. The determination as to whether an other-than-temporary impairment exists and, if so, the amount we consider other-than-temporarily impaired is subjective, as such determinations are based on both factual and subjective information available at the time of assessment. As a result, the timing and amount of other-than-temporary impairments constitute material estimates that are susceptible to significant change.

We are subject to reinvestment risk.

We also are subject to reinvestment risk as a result of changes in interest rates. Declines in interest rates are generally accompanied by increased prepayments of mortgage loans, which in turn results in a prepayment of the related mortgage-backed securities. An increase in prepayments could result in the reinvestment of the proceeds we receive from such prepayments into lower yielding assets.

An increase in prepayment rates may adversely affect our profitability.

The Agency mortgage-backed securities we acquire are backed by pools of mortgage loans. We receive payments, generally, from the payments that are made on these underlying mortgage loans. We often purchase mortgage-backed securities that have a higher coupon rate than the prevailing market interest rates. In exchange for a higher coupon rate, we typically pay a premium over par value to acquire these

impaired securities on at least a quarterly basis and designate such impairments as either "temporary" or "other-than-temporary." If we intend to sell an impaired security, or it is more likely than not that we will be required to sell the impaired security before its anticipated recovery, then we must recognize an other-than-temporary impairment through earnings equal to the entire difference between the mortgage-backed security's amortized cost and its fair value at the balance sheet date. If we do not expect to sell an other-than-temporarily impaired security, only the portion of the other-than-temporary impairment related to credit losses is recognized through earnings with the

mortgage-backed securities. In accordance with U.S. generally accepted accounting principles (GAAP), we amortize the premiums on our mortgage-backed securities over the life of the related mortgage-backed securities. If the mortgage loans securing these mortgage-backed securities prepay at a more rapid rate than anticipated, we will have to amortize our premiums on an accelerated basis that may adversely affect our profitability. Defaults on mortgage loans underlying Agency mortgage-backed securities typically have the same effect as prepayments because of the underlying Agency guarantee

Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by conditions in the housing and financial markets, general economic conditions and the relative interest rates on fixed-rate and adjustable-rate mortgage loans.

While we seek to minimize prepayment risk to the extent practical, in selecting investments we must balance prepayment risk against other risks and the potential returns of each investment. No strategy can completely insulate us from prepayment risk.

The viability of other financial institutions could adversely affect us.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different counterparties, and routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Many of these transactions expose us to credit risk in the event of default of our counterparty or, in certain instances, our counterparty's customers. There is no assurance that any such losses would not materially and adversely impact our revenues, financial condition and earnings.

Our hedging strategies may be costly, and may not hedge our risks as intended.

Our policies permit us to enter into interest rate swaps, caps and floors, interest rate swaptions, Treasury futures and other derivative transactions to help us mitigate our interest rate and prepayment risks described above. We have used interest rate swaps to provide a level of protection against interest rate risks as well as options to enter into interest rate swaps (commonly referred to as interest rate swaptions). We may also purchase or sell to-be-announced forward contracts on Agency mortgage-backed securities

Our use of derivatives may expose us to counterparty risks.

We enter into interest rate swap, swaption and cap agreements to hedge risks associated with movements in interest rates. If a swap counterparty cannot perform under the terms of an interest rate swap, we would not receive payments due under that agreement, we may lose any unrealized gain associated with the interest rate swap, and the hedged liability would cease to be hedged by the interest rate swap. We may also be at risk for any collateral we have pledged to secure our obligations under the interest rate swap if the counterparty becomes insolvent or files for bankruptcy. Similarly, if a swaption or cap counterparty fails to perform under the terms of the agreement, in addition to not receiving payments due under that agreement that would offset our interest expense, we would also incur a loss for all remaining unamortized premium paid for that agreement.

The characteristics of hedging instruments present various concerns, including illiquidity, enforceability, and counterparty risks, which could adversely affect our business and results of operations.

From time to time, we enter into interest rate swap agreements to hedge risks associated with movements in interest rates. Entities entering into interest rate swap agreements are exposed to credit losses in the event of non-performance by counterparties to these transactions.

Effective October 12, 2012, the CFTC issued new rules regarding swaps under the authority granted to it pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act. Although the new rules do not directly affect the negotiations and terms of individual swap transactions between counterparties, they do require that by no later than September 9, 2013, the clearing of all swap transactions through registered derivatives clearing organizations, or swap execution facilities, through standardized documents under which each swap

(commonly referred to as TBAs) and specified Agency securities on a forward basis, purchase or write put or call options on TBA securities and invest in other types of mortgage derivatives, such as interest-only securities. No hedging strategy can protect us completely. Entering into interest rate hedging may fail to protect or could adversely affect us because, among other things: interest rate hedging can be expensive, particularly during periods of volatile interest rates. Available hedges may not correspond directly with the risk for which protection is sought; and the duration of the hedge may not match the duration of the related asset or liability.

counterparty transfers its position to another entity whereby the centralized clearinghouse effectively becomes the counterparty to each side of the swap. It is the intent of the Dodd-Frank Act that the clearing of swaps in this manner is designed to avoid concentration of swap risk in any single entity by spreading and centralizing the risk in the clearinghouse and its members. In addition to greater initial and periodic margin (collateral) requirements and additional transaction fees both by the swap execution

15

facility and the clearinghouse, the swap transactions are now subjected to greater regulation by both the CFTC and the SEC. These additional fees, costs, margin requirements, documentation requirements and regulations could adversely affect our business and results of operations. Additionally, for all swaps we entered into prior to September 9, 2013, we are not required to clear them through the central clearinghouse and these swaps are still subject to the risks of nonperformance by any of the individual counterparties with whom we entered into these transactions. If the swap counterparty cannot perform under the terms of an interest rate swap, we would not receive payments due under that agreement, we may lose any unrealized gain associated with the interest rate swap, and the hedged liability would cease to be hedged by the interest rate swap. We may also be at risk for any collateral we have pledged to secure our obligation under the interest rate swap if the counterparty becomes insolvent or files for bankruptcy. Default by a party with whom we enter into a hedging transaction may result in a loss and force us to cover our commitments, if any, at the then-current market price. Although generally we will seek to reserve the right to terminate our hedging positions, it may not always be possible to dispose of or close out a hedging position without the consent of the hedging counterparty and we may not be able to enter into an offsetting contract in order to cover our risk. There may not always be a liquid secondary market that will exist for hedging instruments purchased or sold and we may be required to maintain a position until exercise or expiration, which could result in losses.

We use analytical models and data in connection with the valuation of our assets, and any incorrect, misleading or incomplete information used in connection therewith would subject us to potential risks.

Given our strategies and the complexity of the valuation of our assets, we must rely heavily on analytical models (both proprietary models developed by us and those supplied by third parties) and be unsuccessful. Furthermore, any valuations of our assets that are based on valuation models may prove to be incorrect.

Some of the risks of relying on analytical models and third-party data are particular to analyzing tranches from securitizations, such as commercial mortgage-backed securities or residential mortgage-backed securities. These risks include, but are not limited to, the following: (i) collateral cash flows and/or liability structures may be incorrectly modeled in all or only certain scenarios, or may be modeled based on simplifying assumptions that lead to errors; (ii) information about collateral may be incorrect, incomplete, or misleading; (iii) collateral or bond historical performance (such as historical prepayments, defaults, cash flows, etc.) may be incorrectly reported, or subject to interpretation (e.g., different issuers may report delinquency statistics based on different definitions of what constitutes a delinquent loan); or (iv) collateral or bond information may be outdated, in which case the models may contain incorrect assumptions as to what has occurred since the date information was last updated.

Some of the analytical models used by us, such as mortgage prepayment models or mortgage default models, are predictive in nature. The use of predictive models has inherent risks. For example, such models may incorrectly forecast future behavior, leading to potential losses on a cash flow and/or a mark-to-market basis. In addition, the predictive models used by us may differ substantially from those models used by other market participants, with the result that valuations based on these predictive models may be substantially higher or lower for certain assets than actual market prices. Furthermore, since predictive models are usually constructed based on historical data supplied by third parties, the success of relying on such models may depend heavily on the accuracy and reliability of the supplied historical data and the ability of these historical models to accurately reflect future periods.

All valuation models rely on correct market data inputs.

information and data supplied by our third party vendors and servicers. Models and data are used to value assets or potential asset purchases and also in connection with hedging our assets. When models and data prove to be incorrect, misleading or incomplete, any decisions made in reliance thereon expose us to potential risks. For example, by relying on models and data, especially valuation models, we may be induced to buy certain assets at prices that are too high, to sell certain other assets at prices that are too low or to miss favorable opportunities altogether. Similarly, any hedging based on faulty models and data may prove to

If incorrect market data is entered into even a well-founded valuation model, the resulting valuations will be incorrect. However, even if market data is inputted correctly, "model prices" will often differ substantially from market prices, especially for securities with complex characteristics, such as derivative instruments or structured notes.

We are highly dependent on information systems and third parties, and systems failures could significantly disrupt our business, which may, in turn, negatively affect the market price of our common stock and our ability to pay dividends to our stockholders.

Our business is highly dependent on communications and information systems. Any failure or interruption of our systems or cyber-attacks or security breaches of our networks or systems could cause delays or other problems in our securities trading activities, including mortgage-backed securities trading activities, which could have a material adverse effect on our operating results and negatively affect the market price of our common stock and our ability to pay dividends to our stockholders. In addition, we also face the risk of operational failure, termination or capacity constraints of any of the third parties with which we do business or that facilitate our business activities, including clearing agents or other financial intermediaries we use to facilitate our securities transactions.

Computer malware, viruses, and computer hacking and phishing attacks have become more prevalent in our industry and may occur on our systems in the future. We rely heavily on our financial, accounting and other data processing systems. It is difficult to determine what, if any, negative impact may directly result from any specific interruption or cyber-attacks or security breaches of our networks or systems or any failure to maintain performance, reliability and security of our technical infrastructure. As a result, any such computer malware, viruses, and computer hacking and phishing attacks may negatively affect our operations.

Our use of non-recourse securitizations may expose us to risks which could result in losses to us.

We may utilize non-recourse securitizations of our assets in mortgage loans, especially loan originations, when they are available. Prior to any such financing, we may seek to finance assets with relatively short-term facilities until a sufficient portfolio is accumulated. As a result, we would be subject to the risk that we would not be able to acquire, during the period that any short-term facilities are available, sufficient eligible assets to maximize the efficiency of a securitization. We also would bear the risk that we would not be able to obtain a new short-term facility or would not be able to renew any short-term facilities after they expire securitizations, our inability to enter into such securitizations would increase our overall exposure to risks associated with direct ownership of such assets, including the risk of default. Our inability to refinance any short-term facilities would also increase our risk because borrowings thereunder would likely be recourse to us as an entity. If we are unable to obtain and renew short-term facilities or to consummate securitizations to finance our assets on a long-term basis, we may be required to seek other forms of potentially less attractive financing or to liquidate assets at an inopportune time or price.

Securitizations expose us to additional risks.

In a securitization structure, we convey a pool of assets to a special purpose vehicle, the issuing entity, and the issuing entity would issue one or more classes of non-recourse notes pursuant to the terms of an indenture. The notes are secured by the pool of assets. In exchange for the transfer of assets to the issuing entity, we receive the cash proceeds of the sale of non-recourse notes and a 100% interest in the subordinate interests of the issuing entity. The securitization of all or a portion of our commercial mortgage loan portfolio might magnify our exposure to losses because any subordinate interest we retain in the issuing entity would be subordinate to the notes issued to investors and we would, therefore, absorb all of the losses sustained with respect to a securitized pool of assets before the owners of the notes experience any losses. Moreover, we cannot be assured that we will be able to access the securitization market or be able to do so at favorable rates. The inability to securitize our portfolio could adversely affect our performance and our ability to grow our business.

Lenders may require us to enter into restrictive covenants relating to our operations that may inhibit our ability to grow our business and increase revenues.

If or when we obtain debt financing, lenders (especially in the case of credit facilities) may impose restrictions on us that would affect our ability to incur additional

should we need more time to seek and acquire sufficient eligible assets for a securitization. In addition, conditions in the capital markets, including the recent unprecedented volatility and disruption in the capital and credit markets, may not permit a non-recourse securitization at any particular time or may make the issuance of any such securitization less attractive to us even when we do have sufficient eligible assets. While we would intend to retain the non-investment grade tranches of securitizations and, therefore, still have exposure to any assets included in such

debt, make certain allocations or acquisitions, reduce liquidity below certain levels, make distributions to our stockholders, redeem debt or equity securities and impact our flexibility to determine our operating policies and strategies. For example, our loan documents may contain negative covenants that limit, among other things, our ability to repurchase our common shares, distribute more than a certain amount of our net income or funds from operations to our stockholders, employ leverage beyond certain amounts, sell assets, engage in mergers or consolidations, grant liens and enter into transactions with affiliates. If we

17

fail to meet or satisfy any of these covenants, we would be in default under these agreements, and our lenders could elect to declare outstanding amounts due and payable, terminate their commitments, require the posting of additional collateral and enforce their interests against existing collateral. We may also be subject to cross-default and acceleration rights and, with respect to collateralized debt, the posting of additional collateral and foreclosure rights upon default. Furthermore, this could also make it difficult for us to satisfy the qualification requirements necessary to maintain our status as a REIT for U.S. federal income tax purposes. A default and resulting repayment acceleration could significantly reduce our liquidity, which could require us to sell our assets to repay amounts due and outstanding. This could also significantly harm our business, financial condition, results of operations and ability to make distributions, which could cause our share price to decline. A default could also significantly limit our financing alternatives such that we would be unable to pursue our leverage strategy, which could adversely affect our returns.

Risks Related To Commercial Real Estate Debt, Preferred Equity Investments and Net Lease Real Estate Assets

The real estate assets we acquire are subject to risks particular to real property, which may adversely affect our returns from certain assets and our ability to make distributions to our stockholders.

We own assets secured by real estate and own real estate directly through direct purchases or upon a default of mortgage loans. Real estate assets are subject to various risks, including:

acts of God, including earthquakes, hurricanes, floods and other natural disasters, which may result in uninsured losses;

acts of war or terrorism, including the consequences of terrorist attacks, such as those that occurred on September 11, 2001;

current or previous owner of real estate (including, in certain circumstances, a secured lender that succeeds to ownership or control of a property) may become liable for the costs of removal or remediation of certain hazardous or toxic substances at, on, under or in its property.

If any of these or similar events occurs, it may reduce our return from an affected property or investment and reduce or eliminate our ability to make distributions to stockholders.

A prolonged economic slowdown or declining real estate values could impair the assets we may own and adversely affect our operating results.

Many of the commercial real estate debt, preferred equity, and real estate assets we may own may be susceptible to economic slowdowns or recessions, which could lead to financial losses in our assets and a decrease in revenues, net income and asset values. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us. These events could result in significant diminution in the value of our assets, prevent us from acquiring additional assets and have an adverse effect on our operating results.

The commercial assets we originate and/or acquire depend on the ability of the property owner to generate net income from operating the property. Failure to do so may result in delinquency and/or foreclosure.

Commercial loans are secured by property and are subject to risks of delinquency and foreclosure, and risks of loss that may be greater than similar risks associated with loans made on the security of single-family residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the income of the

adverse changes in national and local economic and market conditions;

changes in governmental laws and regulations, fiscal policies and zoning ordinances and the related costs of compliance with laws and regulations, fiscal policies and ordinances;

the potential for uninsured or under-insured property losses; and

environmental conditions of the real estate.

Under various U.S. federal, state and local environmental laws, ordinances and regulations, a property is reduced, the borrower's ability to repay the loan may be impaired. The income of an income-producing property can be adversely affected by, among other things,

changes in national, regional or local economic conditions or specific industry segments, including the credit and securitization markets;

declines in regional or local real estate values;

declines in regional or local rental or occupancy rates;

increases in interest rates, real estate tax rates and other operating expenses;

18

- tenant mix;
- success of tenant businesses and the tenant's ability to meet their lease obligations;
- property management decisions;
- property location, condition and design;
- competition from comparable types of properties;
- changes in laws that increase operating expenses or limit rents that may be charged;
- costs of remediation and liabilities associated with environmental conditions;
- the potential for uninsured or underinsured property losses;
- changes in governmental laws and regulations, including fiscal policies, zoning ordinances and environmental legislation and the related costs of compliance;
- acts of God, terrorist attacks, social unrest and civil disturbances;
- the nonrecourse nature of the mortgage loans;
- litigation and condemnation proceedings regarding the properties; and
- bankruptcy proceedings.

In the event of any default under a mortgage loan held directly by us, we will bear a risk of loss of principal to the extent of any deficiency between the value of the collateral and the principal and accrued interest of the mortgage loan, which could have a material adverse effect on our cash flow from operations and limit amounts available for distribution to our stockholders. In the event of the bankruptcy of a mortgage loan borrower, the mortgage loan to such borrower will be deemed to be secured only to the extent of the value of the underlying collateral at the time of bankruptcy (as determined by the bankruptcy court), and the lien securing the mortgage loan will be subject to the avoidance powers of the bankruptcy trustee or debtor-in-possession to the extent the lien is unenforceable under state law. Foreclosure of a mortgage loan can be an expensive and lengthy process, which could have a substantial negative effect on our anticipated return on the foreclosed mortgage loan.

Borrowers May Be Unable To Repay the Remaining

A borrower's ability to repay a mortgage loan on its stated maturity date typically will depend upon its ability either to refinance the mortgage loan or to sell the mortgaged property at a price sufficient to permit repayment. A borrower's ability to achieve either of these goals will be affected by a number of factors, including:

- the availability of, and competition for, credit for commercial real estate projects, which fluctuate over

Principal Balance on the Maturity Date.

Many commercial loans are non-amortizing balloon loans that provide for substantial payments of principal due at their stated maturities. Commercial loans with substantial remaining principal balances at their stated maturity date involve greater risk than fully-amortizing loans. This is because the borrower may be unable to repay the loan at that time.